EDB Eurasian Integration Yearbook 2011

Vinokurov, Evgeny

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Eurasian Development Bank

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Annual publication of the Eurasian Development Bank

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The Eurasian Development Bank is an international financial institution established to promote economic growth and integration processes in Eurasia. The Bank was founded by the intergovernmental agreement signed in January 2006 by the Russian Federation and the Republic of Kazakhstan. In 2009–2010 Armenia, Tajikistan, Belarus became full members of the Bank. Electric power, water and energy, transportation infrastructure and high-tech and innovative industries are the key areas for Bank's financing activity.

As part of its mission the Bank carries out extensive research and analysis of contemporary development issues and trends in the region, with particular focus on Eurasian integration. The Bank also hosts regular conferences and round tables addressing various aspects of integration. In 2008, the Bank launched an annual EDB Eurasian Integration Yearbook (in English) and quarterly Journal of Eurasian Economic Integration (in Russian). Both publications are available online at: www.eabr.org. The Bank's Strategy and Research Department publishes detailed Industry and Country Analytical Reports and plans to undertake a number of research projects. The EDB System of Indicators of Eurasian Integration has become the first project in the pipeline in 2009. In June 2011 the Eurasian Development Bank launched the Centre for Integration Studies. This new analitical structure will focus on the applied research, in particular on the issues of regional economic integration.

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Eurasian Development Bank

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List of Abbreviations

ACDE – Association of Central Depositories of Eurasia
ACF – EurAsEC Anti-Crisis Fund
ADB – Asian Development Bank
ADR – American Depository Receipt
APF – accumulative pension fund
ARMZ – Atomredmetzoloto
ASEAN – Association of South East Asian Nations
ASEAN+3 – the ASEAN member countries plus China, Japan and the Republic of Korea
ASEI – Asian Solar Energy Initiative
BTA – Bank TuranAlem
CA-4 – the four Central Asian states: Kazakhstan, Kyrgyzstan, Uzbekistan and Tajikistan
CAEC – Central Asian Economic Community
CAN – The Andean Community
CAREC – Central Asia Economic Cooperation Program
CEFTA – Central European Free Trade Agreement
CES – Common Economic Space
CIS – Commonwealth of Independent States
CIS IASE – International Association of Stock Exchanges of the CIS
CMEA – Council for Mutual Economic Assistance
COMESA – Common Market for Eastern and Southern Africa
COREPER – the Committee of Permanent Representatives in the European Union
CPI – consumer price index
CRRF – Collective rapid reaction force
CST(O) – Collective Security Treaty (Organisation)
CU – Customs Union
CUC – Customs Union Commission
DFIs – Development Finance Institutions
EAPC – The Euro-Atlantic Partnership Council
EBRD – European Bank for Reconstruction and Development
EC – European Community
ECA – Europe and Central Asia
ECTS – European Credit Transfer and Accumulation System

EDB – Eurasian Development Bank
EEC – European Economic Community
EIB – European Investment Bank
ETS – Eurasian Trade System
EU – European Union
EurAsEC – Eurasian Economic Community
EurAsEC-3 – the three largest EurAsEC countries: Russia, Kazakhstan and Belarus
EurAsEC-5 – the five members of EurAsEC: Russia, Kazakhstan, Kyrgyzstan, Belarus and Tajikistan
FATF – Financial Action Task Force
FDI – foreign direct investment
FFMS – Federal Financial Markets Service
FSA – Agency for Regulation and Supervision of the Financial Markets and Financial Organisations
FSTS – Ukrainian First Stock Trading System
FSU – former Soviet Union states
GDP – gross domestic product
GDR – Global Depository Receipt
GTS – gas transportation system
GU(U)AM – Georgia, Ukraine, Azerbaijan and Moldova
HPP – hydropower plant
IAEA – International Atomic Energy Agency
IBRD – International Bank for Reconstruction and Development
IDA – International Development Association
IDBs – international development banks
IFC – International Finance Corporation
IFI – International Financial Institution
IMF – International Monetary Fund
IOSCO – International Organisation of Securities Commissions
IPA – Interparliamentary Assembly
IsDB – Islamic Development Bank
ITU – International Telecommunications Union
KASE – Kazakhstan Stock Exchange
KDR – Kazakh depository receipt
KTZh – Kazakhstan Temir Zholy
LAFTA – Latin American Free Trade Association
MERCOSUR – Southern Cone Common Market
MFN – most favored nation
MICEX – Moscow Interbank Currency Exchange

MIGA – Multilateral Investment Guarantee Agency
MONEYVAL – Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
MPI – manufacturers' price index
NAFTA – North American Free Trade Agreement
NPP – nuclear power plant
OECD – Organisation for Economic Cooperation and Development
OSCE – Organisation for Security and Cooperation in Europe
PARTAD – Professional Association of Registrars, Transfer Agents and Depositories of Russia
RDR – Russian depository receipt
REER – real effective exchange rates
RER – real bilateral exchange rates
RF – Russian Federation
RFCA – Regional Financial Centre of Almaty
RTA – Regional trade agreements
RTS – Russian Trading System
SAARC – South Asian Association of Regional Cooperation
SADC – South African Development Community
SCO – Shanghai Cooperation Organisation
SCO RATS – Shanghai Cooperation Organisation Regional Antiterrorism Structure
SDR – special drawing rights
SIEI – EDB's System of Indicators of Eurasian Integration
TNCs – transnational companies
UAC – United Aircraft Corporation
UES – Unified Energy System
UN – United Nations
UNECE – United Nations Economic Commission for Europe
UNFCCC – United Nations Framework Convention on Climate Change
USRB – Union State of Russia and Belarus
WB – World Bank
WBG – World Bank Group
WFE – World Federation of Exchanges
WTO – World Trade Organisation

Dear readers,

Over the last year we have made huge strides forward in the process of integration in our region thanks to several major achievements. The Customs Union came into being, the Customs Union countries signed documents establishing the Common Economic Space and talks regarding Kazakhstan and Russia becoming WTO members entered a decisive phase.

The launch of the Customs Union will stimulate economic activity of our member states. Increased trade and investment cooperation in and the expansion of cross-border projects will fuel demand for financial resources. To satisfy this growing demand, financial markets and the banking sector must become more efficient and exploit fully the benefits of financial integration.

The Eurasian Development Bank is five years old this year and is considered to be a truly successful post-Soviet integration project. Its investment and credit portfolio exceeds $2.5 billion, and we have set ourselves the target of $4 billion in the next three years. The Bank is enhancing its cooperation with major financial institutions and the international and national development institutions in its member states in order to promote the exchange of information and interaction on financial markets.

The Bank has invested considerably in the research on the issues of regional economic integration, and in particular the future of financial integration. To this end, the Bank has carried out a major study of integration in the capital markets of Russia and Kazakhstan. Regional financial integration is highly complex, involving the integration of banking capital, banks' penetration into neighbouring markets; the merging of trading floors; and the efficient servicing of cross-border trade and investment flows. Whilst projects and processes initiated at national level are extremely important, the needs and initiatives of enterprise are central to the Bank's existence.

This edition of the EDB Eurasian Integration Yearbook, which the bank has published annually since 2008, is a compilation of authoritative papers and in-depth studies examining the most important aspects and issues of integration. The Bank is committed to studying commercial, economic, monetary and financial integration and to further this aspect of its work established in 2011 the EDB Centre for Integration Studies. This Centre will allow the Bank to continue its extremely valuable contribution to the analysis and support of regional integration.

Igor Finogenov
Chairman of the EDB Executive Board

Dear readers,

Fostering integration within EurAsEC is integral to the economic development policies of its member states. The launch of a regional Customs Union in the post-Soviet space is a remarkable achievement which will bring real benefits for the economies involved. The Customs Union will dramatically reduce costs, boost production and increase the competitiveness of each national economy. After a long period of faltering progress towards integration, the efficient establishment of the Customs Union is testament to the member economies' determination to achieve greater stability and efficiency and to forge ahead with this innovative development initiative.

The creation of the Customs Union between Belarus, Kazakhstan and Russia, the EurAsEC Anti-Crisis Fund and the Common Economic Space are proof of the relevance and potential of regional economic integration. The Customs Union is already bearing fruit according to data showing rapid growth in revenues from commodities traded between Belarus, Kazakhstan and Russia. Its main strategic benefits will come from economies of scale and improvements in global competitiveness in the medium to long term. The Customs Union is open to other countries whose governments choose to join. In April 2011 an official application was received from the government of Kyrgyzstan. If we demonstrate that the Customs Union and the Common Economic Space are truly efficient, they will evolve into the centres of economic integration for the entire post-Soviet space.

The Eurasian Development Bank is one of the most important engines of economic integration. With the inception of the EDB Centre for Integration Studies this year, it will play an even greater role in promoting cross-border projects and trade and investment flows. The Customs Union Commission welcomes this initiative and wishes the new centre every success.

Sergey Glazyev
Deputy General Secretary of EurAsEC
Executive Secretary of the Customs Union Commission
Academician, Russian Academy of Sciences

Dear readers,

It is with great pleasure that we present the 2011 issue of the Eurasian Development Bank's *Eurasian Integration Yearbook*.

In 2010-2011, the Bank's economic analysts have focused on the functioning of the Customs Union, the creation of the Single Economic Space and other key issues affecting regional financial integration. Over the last year we have completed detailed studies of economic cooperation between CIS and EurAsEC member states in hydroelectric energy, nuclear energy, telecommunications, agribusiness, the space industry and stock markets. All these documents are freely available on the Bank's website. The Bank also commissioned the economic forecasting institutes of the Russian Academy of Sciences and the Academy of Sciences of Ukraine to conduct a joint study, which, for the first time, quantitatively assessed the macroeconomic effects of Ukraine's participation in the Customs Union. In common with other analyses of the Customs Union, this study concludes that the fostering of cooperation and real economic integration between member states will generate tangible benefits for individual economies and the organisation as a whole.

For the Bank, the year was marked by several important events. The Council of the EurAsEC Anti-Crisis Fund, which is managed by the Bank, considered preliminary applications from Belarus and Armenia and approved a loan for Tajikistan. In 2010, the Bank opened a representative office in Minsk. Belarus' membership of the Bank provides opportunities for cooperative projects that are vital for the country, and gives Belarusian companies access to the Bank's long-term investment resources.

Our analysts have also been extremely successful in 2010-2011. Last year, the EDB Technical Assistance Fund granted bursaries to more than ten research and publishing projects focusing on regional integration. These bursary competitions for researchers from CIS countries will be held annually. In 2011, we set up the EDB Centre for Integration Studies and we look forward to seeing the results of its work.

I hope that the information and analysis contained in our Yearbook will provide answers to any question regarding the latest developments in post-Soviet integration.

Vladimir Yasinsky
EDB Managing Director
for Strategy and Research Department

A Chronology of Two Decades of Post–Soviet Disintegration and Integration: 1991–2010

Our chronology of two decades from 1991 to 2010 embraces events which we believe have been of importance for the course of post-Soviet integration (and disintegration) in a decisive way. We look at the economic, political, institutional and military aspects, with an emphasis on the economic processes.

1991: disintegration of the Soviet Union and emergence of the Commonwealth of Independent States

December 1991	The Agreement Establishing the Commonwealth of Independent States (CIS) of December 8, 1991.
December 1991	Memorandum of December 21, 1991 to the Agreement Establishing the Commonwealth of Independent States is signed on December 8, 1991 in Minsk by Belarus, Russia and Ukraine.
December 1991	The Almaty Declaration of December 21, 1991.
1991	Creation of a plan to unify the gas infrastructure of Russia, Ukraine and Belarus. The state gas concern Gazprom strives to retain control over its most important assets in the former Soviet Union, primarily the gas transport systems in border republics. These attempts fail, and Gazprom becomes a purely Russian company.

December 1991	Agreement to maintain unified command of the strategic nuclear forces and mass-destruction weapons of the former Soviet Union. For conventional weapons, CIS countries agree to the principle of national armies being subordinate to the CIS Supreme Command.
1991	The Karabakh conflict starts (1991-1994).

1992: post–Soviet cooperation mitigates the consequences of disintegration in the face of a severe economic crisis

February 1992	Trade and Economic Cooperation Agreement of February 14, 1992.
February 1992	Agreement on Customs Policy Principles of March 13, 1992.

May 1992	Agreement on measures to facilitate settlement between businesses in CIS countries of May 15, 1992.
July 1992	Agreement on the status of the CIS Economic Court.
October 1992	Agreement *On the Common Monetary and Credit Policy of States Retaining the Rouble as Lawful Currency* of October 9, 1992.
1992	CIS Industry Councils, including transport and electric power, address the urgent task of preserving common industry systems inherited from the Soviet Union.

February 1992	On February 14, 1992 in Minsk, the heads of CIS countries adopt a declaration of non-use of force, a declaration of adherence to the principles of cooperation (maintaining unified command of armed forces for two years) and the Agreement on the Status of Strategic Forces.
March 1992	The Dnestr conflict between Moldova and the unrecognised Dnestr Moldavian Republic. On July 4, 1992 Russian troops under General Lebed enter the conflict to protect civilians and stop bloodshed. On July 7, 1992 representatives of Russian President arrive in the Dnestr region, and on July 21, Moscow and Chisinau sign the *Agreement On the Principles of Peaceful Settlement of the Armed Conflict in the Dnestr Region of the Republic of Moldova*. A peacekeeping force is deployed in the region to ensure compliance with the terms of the agreement and maintain order. After July 1992 the Dnestr conflict enters a non-violent phase. No agreement on the region's status had so far been reached, and relations between the rival parties remain strained.
March 1992	On March 20, 1992 in Kyiv, agreements on the CIS' collective peacekeeping force, the principles of the formation of the CIS' unified armed forces and the status of CIS border troops and a declaration of non-use of force are all signed.
April 1992	The Ukrainian authorities adopt a number of enactments on the subordination of the Black Sea navy to Ukraine. Russia responds with a decree establishing Russian jurisdiction over the navy "with subordination thereof to the Commander-in-Chief of the Unified Armed Forces of the CIS".
May 1992	From December 1991 to May 1992, in order to minimise the international consequences of disintegration of the Soviet Union, the political concept of Russia as successor of the Soviet Union is developed and introduced internationally. This concept clearly defines Russia's status in four legal matters: nuclear weapons, membership of the UN Security Council, overseas property, and the Soviet Union's foreign debt.
May 1992	A Collective Security Treaty is signed on May 15, 1992 in Tashkent. Moldova, Turkmenistan and Ukraine refuse to join.
July 1992	A peacekeeping force is deployed in the zone of the Georgian-South Ossetian conflict (1991-1992) to control the ceasefire, the withdrawal of troops and maintain order.
August 1992	On August 3, 1992 the Presidents of Russia and Ukraine agree to adjourn the Black Sea navy settlement until the end of 1995. The navy is withdrawn from the CIS Unified Armed Forces and is subordinated directly to the heads of both states.
1992	Civil war begins in Tajikistan (ends in 1997).
October 1992	A peacekeeping force is sent to Tajikistan.

1993: inconclusive initiatives inspired by the EU experience

January 1993	The Charter of the Commonwealth of Independent States of January 22.

January 1993	The Agreement Establishing the Interstate Bank of January 22, 1993 and Charter of the Bank. The protocol of the terms of the Bank's operation in CIS countries of October 18, 1996 is agreed.
February 1993	Gazprom threatens to suspend gas supplies to Ukraine because of arrears. Gas frictions become integral to Russian-Ukrainian politics.
July-August 1993	The rouble zone collapses. From July 26, to August 7, 1993, Russia implements confiscatory monetary reform to withdraw the notes of the State Bank of the Soviet Union from circulation. Another purpose of this reform is to separate the monetary systems of Russia and other CIS countries that are using the rouble as legal currency. In 1992-1993 the former union republics introduce national currencies. The exceptions are Tajikistan (the Russian rouble remains in circulation there until 1995), the unrecognised Dnestr Moldavian Republic (the Dnestr rouble is introduced in 1994) and partly recognised Abkhazia and South Ossetia (the Russian rouble continues to be in circulation).
September 1993	Nine CIS countries sign the Agreement Establishing the Economic Union on September 24, 1993; Turkmenistan and Georgia join later. Ukraine declares it would cooperate with the parties of the Economic Union as an associate member in certain areas corresponding to its national interests.
September 1993	Inspired by the EU experience, on September 24, 1993 CIS countries sign the Agreement Establishing the Eurasian Interstate Coal and Metal Association in order to promote mutually beneficial and equal cooperation in the metal and coal industries, efficient high-tech production, product marketing, employment and welfare. The agreement falls short of its goals, and is formally terminated on September 19, 2003.

May 1993	Russian military bases in CIS countries: Tajikistan The 201st military base in Dushanbe, Kulyab and Kurgan-Tyube is formed on the basis of the 201st motor rifle division which had been stationed in Tajikistan since the autumn of 1945. In 1980-1989 the division saw action in Afghanistan. In the early 1990s, with the outbreak of the Tajik civil war, it fell under Russian jurisdiction as a part of the collective peacekeeping force. The division remains in Tajikistan pursuant to the agreement on friendship, cooperation and mutual aid signed in May 1993. A special agreement on the status and terms of the Russian military presence in Tajikistan is signed in April 1999. On October 16, 2004 the two countries sign an intergovernmental agreement on the personnel and organisational structure of the base.
June 1993	Break-up of the Unified Armed Forces. The post of Commander-in-Chief of the CIS Armed Forces was abolished and the Unified Headquarters was set up to coordinate military cooperation.
June 1993	During a meeting on June 17, 1993, the Presidents of Russia and Ukraine agree to accelerate the division of the Black Sea navy on a parity basis. However, the Moscow Agreement to this end is never ratified.

1994: emergence of the Eurasian Union idea

1994	The Eurasian idea. Kazakh President Nazarbayev puts forward the idea of a new integration grouping, the Eurasian Union, which includes supranational bodies, common defence, a currency, decision-making by a qualified majority, and binding force of adopted decisions for its member states. The proposals are opposed by most CIS countries. The idea of the Eurasian Union is never implemented but is embodied later on in the Eurasian Economic Community (EurAsEC), Customs Union and Common Economic Space.

March 1994	Gazprom discontinues gas supplies to Ukraine and demands the country settle up forthwith by ceding interest in Ukrainian gas pipelines and industrial facilities to Russia.
April 1994	The presidents of Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Uzbekistan and Ukraine sign an agreement establishing a free trade zone on April 15, 1994. The free trade regime applies to Russia's trade with all CIS countries pursuant to corresponding bilateral agreements signed in 1992-1993. Some other CIS members also enter into bilateral free trade agreements.
October 1994	On October 21, 1994 the Agreement Establishing the Payment Union of the CIS is signed by all member states (Ukraine signs it with certain provisos). The Agreement becomes binding for Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia and Uzbekistan.
October 1994	The Agreement Establishing the Interstate Economic Committee of the Economic Union of October 21, 1994. This Committee is a permanent coordinating and executive body of the Economic Union and essentially the first supranational body of the CIS.
November 1994	On November 7, 1994 Gazprom halves its gas supplies to Moldova, and on November 11, the supplies are discontinued. On November 12, Gazprom and Moldovagaz agree to found the joint venture Gazsnabtranzit to which Moldova hands over its export pipelines as repayment of $40 million of its debt.

April 1994	On April 15, 1994 in Moscow, the Presidents of Russia and Ukraine sign an agreement on phased settlement of the dispute over the Black Sea navy. The agreement provides, *inter alia*, that Ukraine receives 18.3% of the ships, and that the Russian and Ukrainian navies are stationed separately.
June 1994	Peacekeepers are deployed in the zone of the Georgian-Abkhazian conflict (1992-1993) with the purpose of localising the war, supervising troop withdrawal, disarmament and guarding military assets.
December 1994	On December 10, 1994 Russia and Kazakhstan sign a 20-year lease agreement for the Baikonur launching site. In 2004 the lease is extended until 2050.
1994	*Partnership for Peace* programmes. All CIS members except Tajikistan (which joins in 2002) participate to a greater or lesser degree.

1995: Russia seals its military presence in CIS countries

January 1995	On January 20, 1995 Belarus and Russia enter into the Agreement Establishing the Customs Union. Kazakhstan and Kyrgyzstan join in mid-1996 and Tajikistan in 1998.
May 1995	The Agreement Establishing the Interstate Currency Committee of May 26, 1995. Ukraine secures the proviso that the agreement would become binding on it only after the introduction of their national currency, and Turkmenistan refuses to join.

January 1995	On January 6, an agreement on Russian radiolocation bases in Belarus is signed. These bases are not classed as military installations. Belarus charges Russia no rent for the use of these assets. The agreement is valid for 25 years.
February 1995	The collective security concept. On February 10, 1995, a unified air defence agreement is signed in Almaty.

March 1995	Russian military bases in CIS countries: Armenia On March 16, 1995, a 25-year agreement on a Russian military base at Gyumri is signed. No rent is charged, and Armenia undertakes to provide all necessary utilities. The mission of Russian troops in Armenia is to cover the southern flank of the Russian Federation and defend Armenia as party to the Collective Security Treaty.
May 1995	The mandate of peacekeeping forces in Tajikistan and Abkhazia is extended. Azerbaijan, Moldova, Turkmenistan, Uzbekistan and Ukraine refuse to join a common border defence agreement.
June 1995	Russia and Ukraine sign a new document under which they would receive 81.7% and 18.3% of the ships, respectively. However, the dispute is not yet permanently settled.
July 1995	Russian military installations in CIS countries: Moldova On July 1, 1995 a Russian task force is organised in the Dnestr region on the basis of the disbanded 14th Army.
September 1995	Russian military installations in CIS countries: Georgia The 12th military installation at Batumi together with three Russian divisions stationed in Georgia receives the status of a Russian military installation in accordance with the Collective Security Treaty of May 15, 1992. On September 15, 1995 in Tbilisi, Russia and Georgia sign an agreement to extend Russian military presence in Georgia for another 25 years. Installations at Vaziani and Gudaut are to be withdrawn by July 2000. In accordance with the Russian-Georgian agreement of March 2006, withdrawal of the 12th installation is to be finalised no later than October 1, 2008. The 62nd military installation at Akhalkalaki is maintained in Georgia on the same grounds as the 12th installation; withdrawal of equipment from this installation starts in May 2006.

1996: multidirectional foreign policy

1996	Russia signs bilateral agreements on measures to promote mutual convertibility and stabilisation of national currencies with Belarus, Kazakhstan, Turkmenistan, Uzbekistan and Kyrgyzstan.
October 1996	Authorised representatives of CIS governments and central banks sign a protocol on the terms of the operation of the Interstate Bank which provides that interested central banks from CIS countries may enter into bilateral agreements with the Interstate Bank on the procedure for and rules of settlement and loan repayment.

January 1996	The Concept of Prevention and Settlement of Conflicts of January 19, 1996. The mandate of a peacekeeping force in Tajikistan is extended.

1997: emergence of the union state of Russia and Belarus and GU(U)AM – two organisations with polar opposite goals. Both lacked success

March 1997	The Concept of Economic Integration Development of the CIS of March 28, 1997.
April 1997	The Union State of Russia and Belarus. An agreement to this end is signed in 1997 based on the Union of Belarus and Russia founded in April 1996 with the aim of creating a single humanitarian, economic and military space. From January 2000 the Union is officially referred to as the Union State.

1997	Emergence of GU(U)AM – an organisation encompassing Azerbaijan, Georgia, Moldova and Ukraine (Uzbekistan is a member in 1999-2005). The goals of GU(U)AM are to promote multilateral cooperation between member states in democratisation, economic development and integration with European countries.
October 1997	The Agreement on Common Non-Tariff Regulation in the Customs Union of October 22, 1997.
October 1997	Azerbaijan, Georgia, Moldova and Ukraine found a new grouping to promote cooperation in trade, economic development, transport and regional security. Uzbekistan joins in April 1999. In 2002 a free trade zone is declared. These initiatives proved inconclusive.

May 1997	The Euro-Atlantic Partnership Council (EAPC) is founded and all CIS countries become members. At this time CIS countries cooperate with NATO within the EAPC and *Partnership for Peace* frameworks. In addition, virtually all CIS countries have bilateral agreements and programmes of cooperation with NATO.
May 1997	An agreement on the terms of division of the Black Sea navy of May 28, 1997 puts an end to the dispute between Russia and Ukraine. This document defines the status of the Russian Black Sea navy and the terms of its presence in Ukraine, and the rules of division and mutual settlement. The Russian navy will be stationed in Ukraine until 2017.
1997	The NATO-Ukraine Special Partnership Charter.

1998: foundation of CAEC and development of the Russian–Kazakh relations – the prospective locomotive of post–Soviet integration

1998	Tajikistan joins the 1994 Agreement on Establishment of the Common Economic Space of Kazakhstan, Kyrgyzstan and Uzbekistan, and the grouping is renamed into Central Asian Economic Community (CAEC).
1998	The CIS countries adopt a number of documents on pensions, visa-free travel, migration, and equal rights of entrance to educational institutions.
July 1998, October 1998	Cornerstone events in Russian-Kazakh relations. In July 1998 the parties sign the *Declaration of Eternal Friendship and Alliance towards the 21st century* (neither Russia nor Kazakhstan have this type of agreement with any other country) and *Agreement on Delimitation of the Northern Part of the Caspian for Exercising Sovereign Subsoil Use Rights*. In addition, the parties sign a protocol on the settlement of the Baikonur financial matters. In October 1998 the Agreement and Programme of Deepening Economic Cooperation between Russia and Kazakhstan in 1998-2007 and a package of cooperation documents are signed.

1999: the first inconclusive attempt at creating the Customs Union and the Common Economic Space

February 1999	The Agreement Establishing the Customs Union and Common Economic Space of February 26, 1999.

April 1999	The Protocol of Intent and Amendments to the Agreement Establishing the Free Trade Zone of April 2, 1999 – a framework document which is to be adapted to the laws of each member state. It is signed by the presidents of Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Uzbekistan and Ukraine. The Protocol introduces a multilateral visa-free regime in the CIS instead of the former bilateral regime, and lifts all customs duties and similar taxes and fees and import and export quotas in mutual trade between the free trade zone.

April 1999	Azerbaijan, Georgia and Uzbekistan elect not to prolong the Collective Security Treaty of May 15, 1992.

2000: dissatisfaction with the scale of cooperation leads to the creation of the Eurasian Economic Community

February 2000	The Agreement on the Common Customs Tariff of February 17, 2000.
February 2000	On February 25, 2000 Gazprom again suspends gas supplies to Moldova on account of having received only one-third of the $15 million payable by the country since the beginning of the year. On February 26, supplies are resumed because the debt was settled.
October 2000	The 1995 Customs Union transforms into the Eurasian Economic Community. The presidents of Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan signed the EurAsEC Agreement on October 10, 2000 in Astana. EurAsEC addresses a wide range of issues, placing an emphasis on economic cooperation and integration (with the ultimate goal of forming a common economic space and common market mechanisms) and coordination of the members' approaches to integration into the global economy and trade. The priority areas for EurAsEC are transport, energy, agribusiness and labour migration.
December 2000	Full-scale parallel operation of the Russian, CIS and Baltic grids is restored for the first time since the break-up of the Soviet Union. By the end of 2000 the grids of 14 former Soviet republics operate in a parallel regime – even more than in the Soviet period.

January 2000	The decision to set up a unified anti-terrorist centre of CIS countries is adopted on January 25, 2000. Peacekeeping forces withdraw from Tajikistan.

2001: SCO

2001	Kazakhstan, China, Kyrgyzstan, Russia, Tajikistan and Uzbekistan found the Shanghai Cooperation Organisation based on the Shanghai Five.

2001	Georgia hosts the first large-scale *Cooperative Partner* military exercises with the participation of NATO troops.

2002: Collective Security Treaty

January 2002	Russian military bases in CIS countries: Azerbaijan On January 25, 2002, an agreement on the terms of use of the Daryal radiolocation base at Gabala was signed. Russia agrees to pay Azerbaijan $7 million in annual rent and another $31 million in compensation for the use of the base from 1997-2001. The agreement is valid for ten years.

2002	The Agreement Establishing the Collective Security Treaty Organisation (Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan).
2002	The Central Asian Cooperation Organisation was founded in 2002. The new organisation succeeds the Central Asian Economic Union founded in 1998, taking on its tasks to promote regional cooperation and stability in Central Asia. The organisation exists until 2005.

2003: the second attempt at creating the Common Economic Space – Ukraine joins

September 2003	The Council of the Heads of CIS Countries resolves to finalise the formation of the free trade zone and enhance economic cooperation.
September 2003	On September 19, 2003 the presidents of Ukraine, Russia, Belarus and Kazakhstan sign the Common Economic Space Declaration, Concept and Agreement.
2003	RAO UES of Russia purchases power assets in Georgia from AES of the United States: AES Telasi (a power distribution company that operates low and medium voltage grids covering Tbilisi and adjacent areas), AES Mtkvari (the owner of unit 9 at the Tbilisi State District Power Plant) and Khramesi (a Hydropower plant comprising Khramesi-1 and Khramesi-2).

September 2003	On September 18, 2003, the Collective Security Treaty Organisation (CSTO) is founded based on the Collective Security Treaty of May 15, 1992.
September 2003	Russian military installations in CIS countries: Kyrgyzstan In the summer of 2002 Russia starts to show keen interest in stationing its task air force at Kant soon after the US and its allies in the anti-terrorist coalition had set up an air base at Manas airport near Bishkek. An intergovernmental agreement on the status and terms of the Russian air force's presence in Kyrgyzstan is signed on September 22, 2003, and the 999th Russian air base is officially opened the next day. The agreement came into effect on August 11, 2005.

2004: the Common Economic Space initiative is suspended

February 2004	On February 18, 2004 Russia discontinues all gas supplies to Belarus, following Minsk's refusal to sign the agreement to establish a joint venture between Gazprom and Beltransgaz until the gas price for 2004 is agreed. Minsk offers \$40 per 1,000 m^3 of gas and Moscow insists on \$50. On February 19, the gas blockade which lasted for 18 hours and 47 minutes is lifted. Belarus begins to buy gas at \$46.68 and Gazprom does not receive any interest in Belarusian gas pipelines.

2004	The Georgian-South Ossetian conflict.
Since 2004	CSTO's joint military exercises of the *Rubezh* series.

2005: an upsurge in economic cooperation at a company and industry (energy, metal, banking, etc.) level in 2005–07

February 2005	On February 16, RAO UES of Russia and the government of Tajikistan sign an agreement on the completion of the Sangtuda–1 HPP. To this end a joint venture of the same name is founded by Inter RAO UES (75%) and the Tajik Ministry of Energy (25%).

March-December 2005	Prices for Russian gas skyrocket. March: the price increase for Belarus is announced, but on April 4, Vladimir Putin promises to keep the price at the current level, and on December 19, the parties finally agree that in 2006 Belarus will receive 21 billion m^3 of gas at $46.68 per 1,000 m^3 (i.e. the price does not change). September: the gas price for Georgia for 2006 increases from $62.5 to $110. For 2007, Gazprom raises the price even further, to $235. November: the forthcoming price increase to $110 for Armenia is announced (the 2005 contract provides for supply of 1.7 billion m^3 at $54). The Armenian government sounds a note of doubt that the country can afford to pay that much. Russia offers Armenia an interest-free loan as compensation for the higher gas price. As an alternative, Russia is prepared to receive title to a generating unit at the Razdanskaya Thermal Power Plant and all Armenian gas pipelines. November: a price increase to $160 for Moldova for 2006 is announced. In 2005 Gazprom supplied gas to the country at $80. For 2007, a price of $170 is agreed. November: Gazprom and Azerbaijan agree that gas supply and transit will be paid for at market prices. In 2006 Azerbaijan receives gas from Gazrpom at $110 (compared to $60 in 2005). Gazrpom intends to raise the 2007 price to $235.

2005	The Ukrainian leadership demands revision of the navy agreement. Ukraine also claims various hydrographic facilities. The Russian lease of the naval base in Sevastopol is partially paid for by gas.

2006: major joint projects, an upsurge in mutual investments and the inception of the Eurasian Development Bank

January 2006	On January 1, 2006 Gazprom suspends supplies to Ukraine. Only gas for transit to European buyers is loaded into the pipeline. According to Gazprom, on January 1-3, Ukraine took 223.5 million m^3 of Russian gas. On January 4, Ukrainian delegation arrived in Moscow and signed an agreement on gas supplies to Ukraine at $230 for five years. Thus Ukraine will receive gas at $95, as Rosukrenergo mixes expensive Russian gas with cheap gas from Central Asia.
March 2006	On March 27, Rospotrebnadzor bans the sale of wine and related components from Georgia and Moldova. On April 26, 2006 the Federal Customs Service is ordered to block import of the Georgian mineral water Borjomi and Nabeglavi for not complying with Russian quality requirements. Since the summer of 2007 over 40 Moldavian wineries have had their products recertified and are permitted to resume sale in Russia. In April 2010 Rospotrebnadzor again rejects a 47,000-litre wine shipment on account of “not complying with the safety requirements”.
June 2006	On January 12, 2006 the Presidents of Russia and Kazakhstan sign the Agreement Establishing the Eurasian Development Bank with a charter capital of $1.5 billion. The Agreement is ratified in June. The Bank is headquartered in Almaty. Armenia and Tajikistan become members in 2009 and Belarus in June 2010.
December 2006	A new gas conflict between Russia and Belarus ends in an uneasy compromise, and Gazprom and Beltransgaz agree the terms of gas supplies and transit for 2007-2011. The price for 2007 is $100 per 1,000 m^3. A price formula for the period from January 1, 2008 is adopted; it is identical to that applying to Russian supplies to Europe. The Belarusian party secures the provision that 55% of supplies in the first half of 2007 will be prepaid and the balance is to be paid not later than July 23; 100% prepayment will be required from July 1.

2006	The Georgian-Abkhazian conflict

2007: negotiations over EurAsEC's Customs Union begin; rapid economic growth triggers a boom in mutual investments in key industries

May 2007	Russia, Kyrgyzstan, Kazakhstan, Belarus, Tajikistan and Armenia sign an agreement establishing a common energy market.
May-August 2007	New gas conflict with Belarus. A joint venture is founded to transport Russian gas through Belarusian territory. Gazprom and the State Property Committee of Belarus sign an agreement under which Gazprom acquires 50% of shares in Beltransgaz for $2.5 billion.
September 2007	Tajikistan terminates the contract for the completion of the Rogun Hydropower Plant with Rusal of Russia. The company is accused of playing into the hands of Uzbekistan as it refused to build a dam to a height of 325 m, which would have enabled Tajikistan to control the region's water resources. Russia later expresses the wish to resume the project but the terms offered by Dushanbe are deemed unacceptable.
October 2007	The Concept of Future Development of the CIS and Plan of Action to this end.
October 2007	The Agreement on the Customs Union Commission of October 6, 2007.
October 2007	The Agreement Establishing a Common Customs Territory and the Customs Union of October 6, 2007.

October 2007	An agreement on peacekeeping activities is signed by the heads of CSTO states on October 6, 2007 and comes into effect on January 15, 2009.

2008: Russian–Georgian war; Georgia's withdrawal from the CIS and Uzbekistan's virtual withdrawal from EurAsEC

January 2008	Agreement on unified tariff and customs regulation of January 25, 2008.
May 2008	Another post-Soviet state, Ukraine, officially joins the WTO on May 19, 2008. Kyrgyzstan did so in 1998 and Georgia joins in 2000.
August 2008	On August 14, 2008 the parliament of Georgia voids documents on the country's membership of the CIS.
October 2008	On October 20, 2008 Uzbekistan suspends its membership of EurAsEC.
November 2008	The Strategy of Economic Development of the CIS until 2020.
December 2008	The Agreement on the procedure of calculating and paying customs duties by Customs Union members of December 12, 2008.

May 2008	On May 23, 2008 the Ukrainian National Security and Defence Council resolves to commence the procedure of joining NATO.

May 2008	On May 20, 2008 Ukrainian President Yuschenko issues a decree entrusting the government to draft a law on terminating the Russian-Ukrainian navy stationing agreements in 2017.
2008	Russia and Georgia wage a war in South Ossetia and Abkhazia.

2009: global economic crisis prompts closer economic cooperation between the post–Soviet countries

January 2009	Russian-Ukrainian disagreements over gas supplies lead to a gas crisis in the beginning of 2009. The absence of a formal agreement between Russia and Ukraine and the unauthorised intake of gas transported through the Ukrainian territory to European consumers prompt Russia to discontinue all gas supplies on January 7, 2009. Russia resumes supplies to Ukraine and gas transit to Europe on January 20, 2009.
January 2009	On January 1, 2009 Uzbekistan discontinues transit of electricity from Turkmenistan to Tajikistan.
February 2009	The Customs Union Commission, a supranational body of Belarus, Kazakhstan and Russia within the EurAsEC framework, holds its first session.
February 2009, June 2009	On February 4, 2009 the Interstate Council of EurAsEC resolves to establish the EurAsEC's Anti-Crisis Fund of $8.5 billion and the High Technology Centre – an organisation in charge of implementing research and technical programmes and innovative projects. A package of documents on the Anti-Crisis Fund is signed on June 9.
March 2009	Russia submits a draft multilateral agreement on a free trade zone to CIS experts. About 110 agreements on mutual trade between different CIS countries are now in effect.
June 2009	A "milk war" between Russia and Belarus bursts out on June 6, 2009. Rospotrebnadzor bans milk import from Belarus on account of the producers' failure to renew their permits in accordance with new Russian technical regulations applying to milk and milk products. On June 18, 2009, during a new round of talks, the parties agree that Belarusian producers will gradually renew their export documents.
June 2009, August 2009	On June 10, 2009 Georgian President Saakashvili declares Georgia's withdrawal from the CIS. On June 12, 2009 the Georgian parliament unanimously adopt two resolutions on the CIS Interparliamentary Assembly. The formal procedure of Georgia's withdrawal is finalised on August 18, 2009, and non-all-CIS agreements and resolutions of CIS bodies cease to be binding on the country. However, Georgia remains party to a number of important multilateral economic agreements regulating trade, transport and intellectual property protection in the CIS.
July 2009	The fourth and last generating unit with a capacity of 670 MW is launched at the Russian-Tajik Sangtuda Hydropower Plant.
October 2009	Russia, Belarus and Kazakhstan agree all constitutional documents of the Customs Union, including the final version of the Customs Code. The states negotiate procedures relating to the external Russian-Kazakh and Russian-Belarusian borders, which are scheduled to start functioning on July 1, 2010 and July 1, 2011 respectively. A common customs tariff is agreed and submitted for approval.
November 2009	On the closure of a EurAsEC Interstate Council session, the presidents of the countries in attendance sign a package of documents on the inception of the Customs Union on January 1, 2010. The Customs Code Agreement of November 27, 2009.

December 2009	On December 1, 2009 Uzbekistan withdraws from the Unified Energy System of Central Asia.
December 2009	December 14, 2009 Turkmen President Berdymukhamedov, Kazakh President Nazarbayev, Uzbek President Karimov and Chinese president Hu Jintao open the Turkmenistan-China gas pipeline, putting an end to Gazprom's monopoly on Turkmen gas.
December 2009	Russia offers Belarus duty-free supplies of oil for internal consumption (6 million tons a year). All other oil supplies are subject to export duties. Since 2010 the reduction factor ceases to apply to oil and oil products supplied to Belarus (in 2009 it was 0.356). The Belarusian party insists on preserving this factor but Moscow refuses.
December 2009	The presidents of Russia, Belarus and Kazakhstan announce that the Common Economic Space will be formed by January 1, 2012.

February-June 2009	On February 19, the Kyrgyz parliament repudiates the agreement with the US on the Manas air base, and on March 6, repudiates agreements with the 11 states of the anti-terrorist coalition whose military personnel are stationed at Manas. It had been agreed that in the event of unilateral termination by either party the other party must be given 180 days to complete all procedures required for the closure of the military installation. The coalition's military personnel are to leave Kyrgyzstan not later than August 20, 2009. However, on June 22, Kyrgyzstan and the US sign an agreement on a US transit centre at Manas to support anti-terrorist activities in Afghanistan.
February 2009	On February 4, 2009 the presidents of CSTO states adopt the resolution to form the Collective Rapid Response Forces, and sign package of corresponding documents on June 14, 2009.
June 2009	Armenia, Kazakhstan, Kyrgyzstan, Russia and Tajikistan sign the Collective Rapid Response Forces Agreement on June 14, 2009, at a CSTO summit. Belarus refuses to attend the summit on account of "economic discrimination" by Russia. Russia acts as chair in place of Belarus. The technical chairmanship of CSTO is to continue until a final decision on chairmanship is made.
July 2009	On July 2, 2009 the Foreign Ministry of Ukraine calls on Russia to return navigation and hydrographic facilities used by the Russian Black Sea navy. Earlier, Ukrainian courts adopted resolutions that these facilities must be handed over to Ukraine, but the Russian navy command refused to obey them.
2009	Scheduled CSTO military exercises West 2009 and Interaction 2009 in Belarus and Kazakhstan (team-building war-games by the CRRF).

2010: inception of the Customs Union and preparation of constitutional documents of the Common Economic Space of Belarus, Kazakhstan and Russia

January 2010	The common customs tariff of the Customs Union becomes effective.
January 2010	Starting early 2010 Russia and Belarus discuss the volume of duty-free oil supplies to Belarus. On March 17, the parties agree that, after the inception of the single customs space in 2012, all customs duties will be lifted. Until that time Russia is to supply 6.3 million tons of oil for internal consumption by Belarus. However, on March 25, Belarus files a claim with the CIS Economic Court demanding that Russia cancel the customs duties imposed since January.
February 2010	The idea of Ukraine joining the Customs Union of Russia, Belarus and Kazakhstan is voiced for the first time.

February 2010	Gazprom receives 50% of shares in Beltransgaz on February 25, 2010; changes follow on March 2, 2010.
April 2010	On April 2, 2010 the Antimonopoly Committee of Ukraine permits the Moscow Interbank Currency Exchange (MICEX) to acquire more than 50% of shares in the First Stock Trading System. As a result, MICEX will have over 50% of votes in the supreme managing body of this Ukrainian stock exchange.
April 2010	On April 21, 2010 gas supply agreements are signed by Gazprom and Naftogaz of Ukraine. In 2010 Ukraine is to receive 36.5 billion m^3 of gas at a discount of $100 – however, not more than 30% of the gas price. The discount applies to 30 billion m^3 in 2010 and 40 billion m^3 in each subsequent year.
May 2010	On May 28, 2010 the Prime Minister of Belarus fails to attend tripartite talks in St. Petersburg, and Russia and Kazakhstan made a number of agreements on the Customs Union bilaterally. The parties sign documents introducing the Customs Code from July 1, 2010 and some amendments to the Customs Code. Belarus signs these documents a few days later.
June 2010	On June 11, 2010 the leaders of SCO states sign the regulation *On Procedure for Admitting New Members to the SCO*. In view of the organisation's requirements, the most likely candidates for membership are India, Pakistan and Mongolia, which already have the observer status.
June 2010	On June 18, 2010 the EurAsEC Anti-Crisis Fund Council satisfies the first application for aid. The St. Petersburg meeting of the finance ministers of the member states (Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Armenia) resolves to provide Tajikistan with a loan of $70 million at a fixed interest rate of 1% per annum for 20 years.
June 2010	The gas conflict between Russia and Belarus.
July 2010	The Customs Code becomes effective (for Russia and Kazakhstan on July 1, 2010 and for Belarus on July 6).
December 2010	On December 9, the heads of the three states sign a package of documents on the Common Economic Space, which is to be launched on January 1, 2011.

March 2010	On March 4, 2010 the lease of Baikonur is extended until 2050.
April 2010	On April 21, 2010 the presidents of Russia and Ukraine hold talks and sign an agreement to extend the term of presence of the Russian Black Sea navy in Crimea for 25 more years after 2017. The agreement is ratified by the national parliaments on April 27. On April 21, a supplementary agreement to the gas supply agreement of January 19, 2009 is signed in Kharkov; it provides for a 30% discount on gas supplies to Ukraine in exchange for the extension of the Russian navy presence in Sevastopol until 2042 (the initial agreement expires in 2017). The rent increases pro rata the discount.
June 2010	CSTO exclude the use of force for the settlement of the armed conflict in the south of Kyrgyzstan. On June 14, the Secretaries of national Security Councils of CSTO states resolve to provide aid to Kyrgyzstan including aircraft, equipment, military transport, etc., but not arms.

Declaration of independence by the former Soviet Union republics

Republic	Declaration of sovereignty	Declaration of independence	De jure independence
Estonia	November 16, 1988	August 20, 1991	September 6, 1991
Latvia	July 28, 1989	August 21, 1991	September 6, 1991
Lithuania	April 18, 1989	March 11, 1990	September 6, 1991
Georgia	May 26, 1990	April 9, 1991	December 26, 1991
Russia	June 12, 1990	—	December 26, 1991
Moldova	June 23, 1990	August 27, 1991	December 26, 1991
Ukraine	July 16, 1990	August 24, 1991	December 26, 1991
Belarus	July 27, 1990	August 25, 1991	December 26, 1991
Turkmenistan	August 22, 1990	October 27, 1991	December 26, 1991
Armenia	August 24, 1990	September 23, 1991	December 26, 1991
Tajikistan	August 24, 1990	September 9, 1991	December 26, 1991
Kyrgyzstan	December 15, 1990	August 31, 1991	December 26, 1991
Kazakhstan	October 25, 1990	December 16, 1991	December 26, 1991
Uzbekistan	June 20, 1990	August 31, 1991	December 26, 1991
Azerbaijan	October 18, 1991	August 30, 1991	December 26, 1991

Trends in Investment Cooperation between CIS Countries and the Global Economic Crisis*

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Crisis impact on CIS economies

The Commonwealth of Independent States (CIS) remained the most rapidly growing region in the global economy throughout the 2000s. In 2003-2007, it was second only to Asian emerging markets in terms of annual economic growth rates. On the other hand, the region suffered worst from the fallout of the global economic and financial crisis: in 2009 real gross domestic product (GDP) in post-Soviet countries dropped by 6.6%, compared to 3.7% in Central and Eastern Europe, 1.8% in the western hemisphere, and continuing economic growth in some developing countries (IMF, 2010).

The economic dynamics varied greatly across the CIS. The worst GDP drop was recorded in Ukraine and Armenia (by 15.1% and 14.2% respectively); these countries were followed by Russia and Moldova (7.9% and 6.5% respectively) in 2009. The Belarusian and Kazakh economies were nearly stagnant. At the same time, Azerbaijan, Turkmenistan and Uzbekistan demonstrated economic growth at over 4%.

However, this general GDP performance was the product of complex interaction between very different components. The crisis has the most serious negative influence in investment demand. Investments in fixed assets in 2009 declined in six of the ten region's countries for which data is available. The largest decline in investments was observed in Ukraine (41% of the previous year's level), Armenia (37%) and Moldova (35%). In Azerbaijan and Tajikistan, investments dropped by 18% and in Russia by 16% (according to the CIS Interstate Statistics Committee).

This decline in investment in national economies was largely attributable to the decrease in foreign capital inflow. According to balance of payments

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statistics, direct investments in 2009 dropped by 51% from the 2008 level in Russia, by 20% in Kazakhstan, by 13.6% in Belarus, and by 56% in Ukraine (International Financial Statistics, November 2010). Notably, in 2009 the item *Other Investments & Payables* in the balance of payments of Russia, Kazakhstan and Ukraine became negative, which indicated not only disruption of capital inflow through this channel (which had been the principal source of foreign investments in the pre-crisis period), but also reversion of capital flows (particularly, repayment of foreign debt).

We can identify several directions of the impact of the crisis on investments and the general economic dynamics in CIS countries:

1) reduced opportunities to raise capital or refinance existing debt on global financial markets, which led to a decline in portfolio and other investments. This influence became evident at an early stage of the crisis and first affected the CIS' most developed and open financial systems (those of Kazakhstan, Russia and Ukraine);

2) decrease of foreign direct investments resulting from challenges faced by parent companies in their home countries and a lack of global demand for the products of recipient companies from the CIS - most of these are from the extractive or metallurgy sectors which were suffering from collapsing prices[1];

3) persisting decline in foreign investment due to internal factors (recession in national economies and a lack of domestic demand). This factor was especially critical to investment in companies oriented towards domestic markets.

The discussion of the main trends in investment cooperation between the CIS countries during the time of the crisis and a preliminary assessment of the role of the intraregional channel in delivering crisis fallout to these economies are offered below.

The hypotheses

Prior to the crisis joint investment was the most rapidly growing area of economic cooperation within the CIS. The emerging Russian transnational companies (TNCs) started a massive invasion into post-Soviet markets, and were joined by TNCs from Kazakhstan in the mid-2000s. The preconditions for this boom were the high rates of economic growth in both TNCs' home countries, which allowed the TNCs to gather momentum for entering regional markets, and recipient countries, which made them attractive targets for investment.

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[1] *According to the IMF, in 2009 annual average prices of oil dropped by 36.3% and prices of metals by 28.6% (IMF, 2010).*

This model of regional integration could not escape the influence of the 2008-2010 crisis. Obviously, Russian and Kazakh TNCs had to revise their overseas investment strategies. It is hardly possible to identify any general direction of this transformation. To simplify the task, we offer three hypotheses of how the crisis influences investment cooperation in the CIS; we will term them investment recession; replacement growth; and interstate cooperation. Whereas our first hypothesis is based on the assumption that investment cooperation between CIS countries has declined to some degree, the other two, by contrast, forecast an upsurge or at least sustained continuation of investment activity, however, driven by different factors.

Investment recession. The most readily forthcoming assumption is that progress in investment activity has been suspended or even reversed. The crisis reduced the financial potential of Russian and Kazakh companies (particularly, their ability to raise the foreign capital necessary to support their expansion in the CIS or overseas sales), made them more cautious about selecting potential investment targets abroad, and forced them to give up many ambitious projects, while concentrating on consolidation of assets in their home countries. In this case the logical chain appears fairly simple: a decline in business activity and hostile environment causes companies to phase out their international business to the detriment of domestic business and to refrain from embarking on new projects to the detriment of on-going ones.

Replacement growth. A drawback to the investment recession hypothesis is that it effectively ignores the possible reaction of intraregional players and businesses from recipient countries to the changing global and regional situation. In recent years the most serious factor restricting Russian expansion was competition from large TNCs from highly industrialised countries. The latter also had to limit their activity, thus vacating a niche for Russian corporations. Similarly, the crisis led to a dramatic depreciation of assets located in the CIS countries and made their owners and beneficiaries more concessive. As a result, although the resources of post-Soviet TNCs formally shrank, in fact they may have even increased as external pressure eased, which in turn would have led to an increase in investments.

In other words, the 2008-2010 crisis can be viewed as the "creative destruction" process in which a new system of interrelations emerges and replaces the existing one; the intensity of economic cooperation declines in one place and increases in another. It is important to remember that, whereas the crisis did impede transnational expansion in quantitative terms, it may well be the case that TNCs sacrifice their "image" projects for the sake of transactions that pay back. And this, in a longer term, works to promote regionalisation. We cannot subject this assumption to any reliable empirical study due to the scarcity of available data, but at least it cannot be discarded.

Interstate cooperation. The crisis has affected not only regionalisation: during its two years, some serious positive developments were observed in interstate cooperation both within the framework of formal integration initiatives and on a bilateral basis. The crisis forced states to adopt a more cooperative stance. This was dictated by the need to overcome the crisis fallout (EurAsEC Anti-Crisis Fund) and a broader integration agenda (Customs Union). Generally, an upsurge in formal cooperation in crisis time is a peculiarity of post-Soviet integration (which makes it distinct from many other integration projects) (Libman, Vinokurov, 2010). Whereas in the mid-2000s some CIS governments were becoming increasingly sceptical of foreign investment in general (e.g. in Kazakhstan) (Libman, Ushkalova, 2009) or, more particularly, Russian companies' involvement in key economic sectors (e.g. in Tajikistan) (Libman, 2009), the recession and need for investments may have reversed this sentiment.

In addition, the severe economic crisis of 2008-2009 fostered political changes in Ukraine and created preconditions for the improvement of relations with Russia in 2010 with favourable implications for business. This can be viewed as an indirect positive impact of the crisis. Since April 2010, broader Russian involvement with the Ukrainian economy was discussed at many occasions: primarily regarding access to denationalised Ukrainian assets for Russian companies, and also broader cooperation in key sectors such as nuclear power, aircraft building and ship building (Rosbalt-Ukraine, April 24, 2010; Gritsenko, 2010).

An upsurge in interstate cooperation can also influence business activity through other channels. The fact that the government is assuming a more active role in the Russian (and, to a lesser extent, Kazakh) economy is obvious, and the influence of this process on the overseas policies of Russian companies is not uniform. Many observers theorise that the government's influence on overseas transactions by Russian companies is not significant or at least does not contradict the standard decision-making logic (Vahtra, 2007); the state's presence in key sectors targeted by foreign expansion (e.g. oil & gas) is limited in principle (Hanson, 2009). However, we can assume that in crisis time at least selected large transactions are being made under government pressure (as the government's role as the main source of support is increasing), i.e. for political considerations; later we will discuss this factor in more detail.

We should stress that all these hypotheses are largely speculative. The investment recession hypothesis is based on the premise that the resources of Russian businesses have shrunk; it is not definite, however, bearing in mind sizeable government support programmes that target large corporations.

The replacement growth hypothesis essentially assumes that companies from post-Soviet states are the only group capable of seizing the vacated niche. But there are a number of other countries whose foreign trade has been affected by the crisis even less than that of Russia, and they are also keen to expand their presence in post-Soviet markets; this is particularly the case for China (SKOLKOVO, 2009).

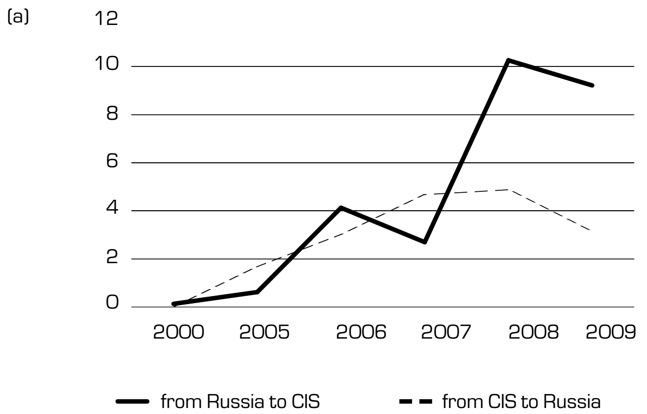
The assessment of formal progress in formal integration is not as easy as it may seem. Firstly, we should remember the example of "integration for survival" in the 1990s, when similar factors (economic hardship) encouraged businesses to actively pretend integration without any real action (Libman, 2007). Secondly, even if we assume that the existing institutions do function (for the Customs Union that statement is fairly true, at least for now); their impact on the business is not yet clear. There are grounds for expecting the emerging system to be overly intricate and plagued by inconsistencies (at least in the medium term), which may impede cooperation. Thirdly, as has been noted on many occasions, a formal institutional environment is no advantage for Russian business: quite the opposite, it functions far more confidently under unclear and poorly formalised rules.

Now we will attempt to summarise at least some indirect evidences in support of the above hypotheses. We will focus on the first two hypotheses: interstate cooperation will be discussed only to the extent to which Russian corporations are exposed to political pressure in crisis time. Let us look at official statistics, published news, and information available from corporate websites. These sources should be treated with a degree of caution in the context of our study. Official statistics obviously understates investments in post-Soviet countries; in addition, investments vary considerably from one country to another. It is likely that official figures will include payments under transactions made in the pre-crisis period, i.e. the impact of the crisis will be reflected with a time lag. As for press releases and corporate websites, this information is likely to distort the picture in favour of replacement growth: typically, start-up of a new transaction or project receives much greater coverage than any consequent withdrawal (with the exception of very large transactions). These circumstances should be kept in mind when looking at the empirical data (largely incomplete or indirect) available to us.

Finally, we should remember that the outbreak of the crisis coincided with the next phase of quantitative transformation of Russian TNCs, i.e. their geographic reorientation. The notion that the post-Soviet space is an isolated region, the development of which is determined principally by its internal logic has little to do with reality. Informal integration has long since moved beyond the borders of the former Soviet Union, although the scale of this process varies depending on the form of business activity. Whereas the traditional targets for Russian investment are European and post-Soviet countries (SKOLKOVO, 2008; Sethi, 2009), in recent years Russian expansion went further, to Africa and Asia (Kuznetsov, 2010). The fact that this phase coincided with the outbreak of the crisis complicates the task of verifying our hypotheses.

Investment cooperation as reflected by national statistics

First, let us look at quantitative data on investments in post-Soviet countries. To evaluate Russian investment in the region, we will use two main sources: the Federal State Statistics Service of the Russian Federation, and the balance of payments (as stated by the Central Bank of Russia). As shown in *Figure 2.1a*, in 2009 both Russian investments in CIS countries and investments by CIS countries in Russia declined significantly (according to data from the Federal State Statistics Service). The decrease



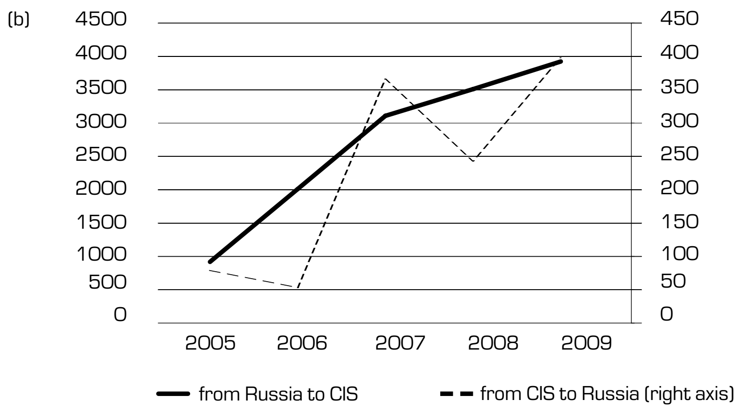


Figure 2.1. Inflow of investments from Russia to CIS countries

Source: Federal State Statistics Service of Russia; Bank of Russia

Note: a) $ billion; b) direct investments, $ million, Central Bank (balance of payments) was about 10% for Russian investments and over 30% for investments by CIS countries. This trend was observed in all post-Soviet states except Tajikistan, Moldova and Turkmenistan (whose investments in the Russian economy increased; however, these three countries together contribute only 2% of all investment). For example, Ukraine's investments in Russia in 2009 reached only 43% of the 2008 level; the same indices for Kazakhstan and Belarus were 61% and 72%, respectively.

Whilst Russian investments in CIS countries increased significantly in 2008, investments by Ukraine and Kazakhstan in Russia declined. Interestingly, if we exclude Belarus from our analysis of 2009, we will obtain a picture of serious decline in Russian investments: 65% of the 2008 level in Ukraine and 51% in Kazakhstan. Thus, quantitative indicators of investment activity clearly speak in favour of the investment recession hypothesis, although this conclusion is better justified for CIS countries than for Russia itself. The crisis also reversed the upward trend in CIS countries' investments in Russia (Libman, 2008): Russian investments clearly prevailed in the investment balance of 2009, mainly due to a sharp increase in 2008 when other CIS countries were already exposed to the crisis. This is logical, bearing in mind the role of financial system component of the crisis in Kazakhstan and deep economic recession in Ukraine.

Russian direct investments data from the balance of payments (see Figure 2.1b) present a somewhat different picture. The 2008-2009 crisis did not suspend the growth of Russian investments in post-Soviet economies, but caused it to slow. Investments from CIS countries did indeed drop in 2008, but then continued to increase. The situation with portfolio investments was not as good (Golovnin, Ushkalova, Yakusheva, 2010). The assets of Russian investors in the CIS shrank from $113 million to $24 million in 2008, but in 2009 increased to $71 million, thus exceeding the 2006 level, yet falling short of the 2007 level. Payables dropped from $192 million in 2007 to $152 million in 2008, and the year 2009 saw net withdrawal of CIS countries' portfolio investments from Russia, with a slight improvement in the first quarter of 2010 (however, the pre-crisis level was much higher).

An analysis of CIS national statistics allows us to look at the situation from a different perspective.

According to the National Statistics Committee of Kyrgyzstan (see Figure 2.2a), investments from other CIS countries to this country in 2009 were 10% down, whilst Russian investments increased significantly (by contrast, Russian statistics indicate a significant decrease). Kazakhstan's standing in the Kyrgyz economy deteriorated: whereas in 2007-2008 it nearly achieved the status of the largest foreign investor, in 2009 its investments in the country shrank dramatically. Notably, the overall investment inflow into Kyrgyzstan continued to grow, but the level of Chinese

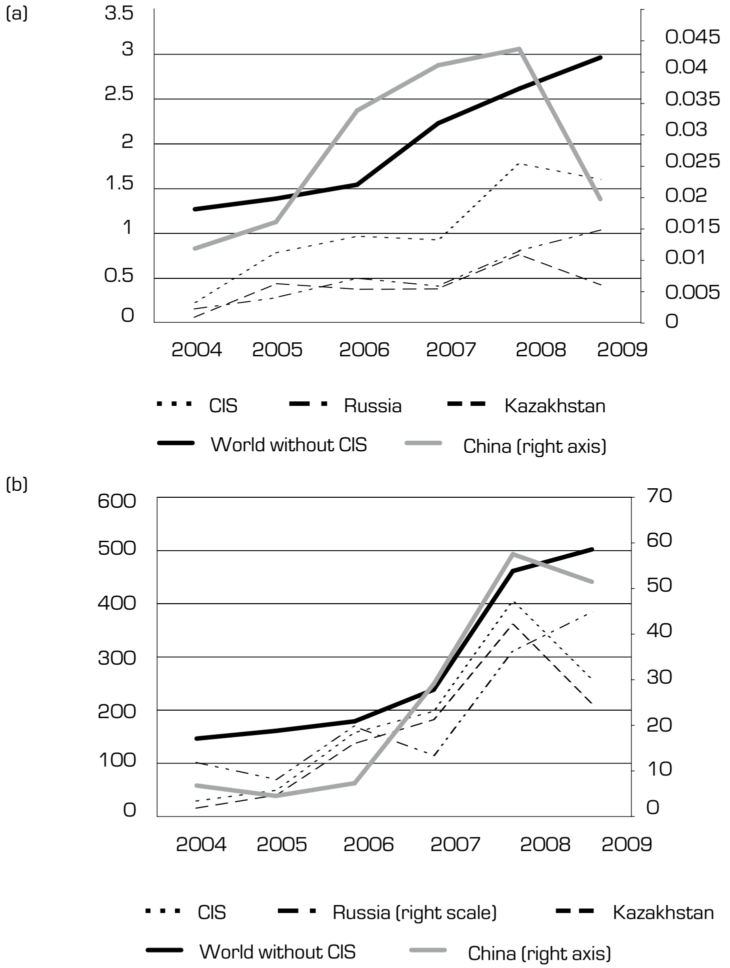


Figure 2.2.
Inflow of investments and direct investments in Kyrgyzstan

Source: National Statistics Committee of Kyrgyzstan

Note: a) $ billion, b) $ million

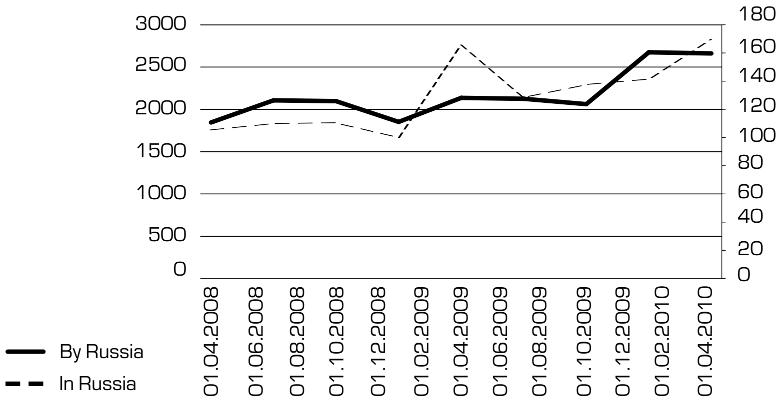
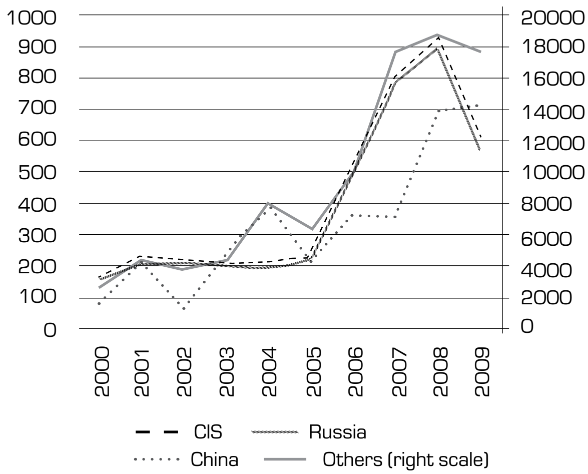


Figure 2.3.
Accumulated direct investments by Ukraine in Russia and by Russia in Ukraine

Source: State Statistics Committee of Ukraine

Note: right scale (Accumulated direct investments by Ukraine in Russia, $ million) capital decreased, i.e. there were no signs of "seizing the niche". Direct investments showed comparable dynamics (see Figure 2.2b): investments from CIS countries dropped by 35%, and investments from Kazakhstan (the main source of foreign investments) dropped by more than 40%; the decrease in Chinese investments was not as big, and Russian investments increased slightly.

According to Ukrainian statistics (see Figure 2.3), slow but sustained growth in accumulated investments by Russia in Ukraine and by Ukraine in Russia was observed in 2008-2010, except several short periods of decline. The assessment of this data is complicated by the fact that the main investor in Ukraine is Cyprus, which, in the opinion of some experts, masks the inflow of Russian capital, especially into the financial sector (Obozrevatel, June 12, 2010).



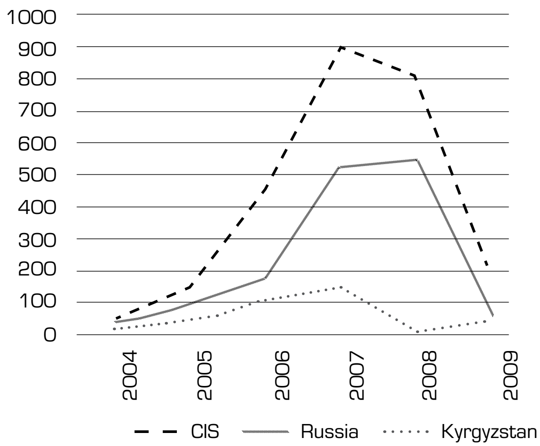
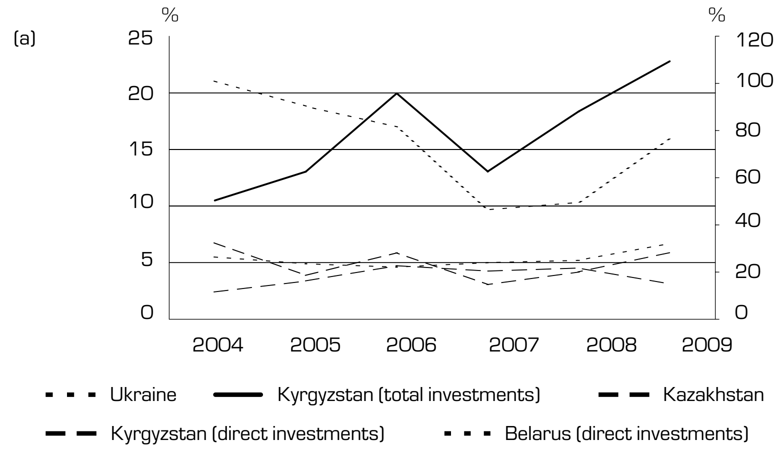


Figure 2.4.
Investment inflow and outflow in/from Kazakhstan ($ million)

Source: National Bank of Kazakhstan

Kazakhstan's statistics are most supportive of the negative expectations of investment recession. Investments by CIS countries in the Kazakh economy dropped sharply, which is attributable mainly to Russian withdrawal. In 2009, Kazakh investments in CIS countries dropped eight times, and investments in Russia nearly ten times (however, investments in Kyrgyzstan grew slightly, but this trend was unsustainable[2] and turned into withdrawal in the first quarter of 2010). Total investments in



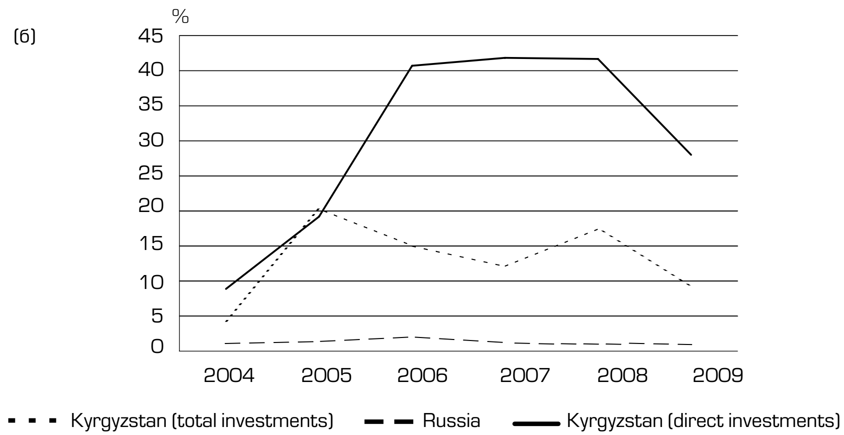


Figure 2.5.
The share of Russian (a) and Kazakh (b) investments in total investments in CIS countries

Sources: see Figures 2.1–2.4; for Belarus – the National Bank of Belarus

Notes: For Ukraine – share in accumulated direct investments as at January 1, of the following year; for Belarus – data on direct investments; the share is calculated as ratio of the *Payables (Direct Investments)* item of the financial account of the balance of payments in respect of Russia to the credit of the *Investments in Domestic Economy (Direct Investments)* item of the financial account of the balance of payments. For Russia – data from the Federal State Statistics Service. Data for Belarus is shown in the right scale

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[2] *This contradicts Kyrgyz statistics.*

Kazakhstan from other world countries also declined in 2009 compared to 2008, but investments from China slightly increased.

In the case of Belarus, we can use data from the balance of payments in respect of Russia that reflects the inflow of direct investments into the country. However, this source contains no indications of decline during the crisis, showing gradual growth from $828.6 million in 2007 to $1.0688 billion in 2008 and $1.4201 billion in 2009. This effect may be attributable to Gazprom's regular payments for the purchase of Beltransgaz (Heifetz, 2009; Yeremeeva, 2009).

In Figure 2.5a we summarise our analysis of the Russian share in total investments in CIS countries. This share increased in three of the four countries under review (Belarus, Kyrgyzstan and Ukraine), and slightly decreased in Kazakhstan. Data on Kazakhstan's overseas investments (see Figure 2.5b) are available only for Kyrgyzstan and Russia: in both countries Kazakhstan's share in total investments shrank in 2009. In other words, Russia's scenario fits the replacement growth hypothesis, whilst pure investment recession is being observed in Kazakhstan.

Summing up these quantitative assessments, we should note that the 2008-2009 statistics differ significantly in individual CIS countries and may lead to contradicting conclusions. However, we can say safely that the crisis has resulted in dramatic decrease of Kazakhstan's investments in post-Soviet countries (especially in Russia; the situation with Kyrgyz assets is somewhat more difficult to assess). Russia's situation was not as plain: although it had a period of decline in 2009, this decline was less dramatic than in other CIS countries (according to Ukrainian statistics, there were no setbacks at all). On the whole, quantitative data cannot decisively justify the investment recession hypothesis in the case of Russia. Its standing should not be overestimated, since the results of the assessment were strongly influenced by investments in Belarus. However, the Russian share in total investments did increase, which flatly correlates with the replacement growth hypothesis. Finally, the behaviour of external players was also not uniform: China was actively expanding its presence in Kazakhstan but withdrawing from Kyrgyzstan.

Another drawback of quantitative analysis is the fact that the crisis has forced businesses to actively employ various non-transparent investment schemes in order to optimise accounts. Of course, under increasing pressure from fiscal authorities (which were concerned about dramatic decline in tax revenue in crisis time) business practices may have ultimately reverted to type, but it is very likely that what we observed in 2009 was not a decline in investments but transfer of a large number of transactions to the informal sector or a boom in offshore schemes (which in any case dominate the mutual investments structure in the CIS). Therefore we deem it necessary to look into individual transactions and companies in post-Soviet states in the crisis period.

Key transactions: general trends

The picture resulting from an analysis of individual transactions is somewhat different from that painted by the statistics. In this section we concentrate on Russian investment projects. There is practically no news of any recent investment initiatives from Kazakhstan, and not surprisingly: the country's strong financial sector which had been the main engine of its expansion in CIS markets fell as the first victim of the global crisis. In essence, Kazakhstan was the only CIS economy that fully suffered the first tide of the crisis in 2007-2008 (Golovnin, Ushkalova, Yakusheva, 2010:5).

To date there are several assessments of Russian TNCs' response to the crisis from the perspective of expansion beyond the CIS (Kuznetsov, 2009; Vahtra, 2009; SKOLKOVO, 2009). During the first half of 2008 Russian overseas investment activity continued in direct contradiction to the global downward trend. Moreover, according to some sources (Kuznetsov, Chetverikova, 2009), leading TNCs started to reduce staff in Russia in the pre-crisis period whilst hiring more personnel for their overseas subsidiaries. Their standing deteriorated in the second half of 2008, i.e. when the second wave of the crisis reached CIS countries. Many transactions were cancelled or postponed for the indefinite future. Notably, it was the most active players in the past years' expansion who had to revise their strategies. However, it would be incorrect to speak about a standstill, as overseas assets of Russian companies grew continuously in the face of the crisis.

As for situation in the CIS region, at an early stage of the crisis some Russian companies were forced to abandon their projects[3], particularly, in construction (PIK, Inteco, Mirax Group) in Ukraine. Thus, in October 2008, Inteco froze its project to construct the Moskovskiy residential district in Kyiv. Mirax Group sold its unfinished Mirax Plaza Ukraine skyscraper in Kyiv to AEON (Pappe, 2009) – the latter is also Russian-controlled. The situation in Russia's building industry was extremely adverse even against the backdrop of the overall economic recession; incidentally, this industry was hit by the crisis at an early stage. In 2009, Russian construction companies made a number of large transactions in Ukraine: Promyshlenniy Kontsern acquired 99.99% in Planeta-Bud (which had suffered a 57.8% loss of profit)[4] in Crimea. As

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[3] According to some estimates, this trend was attributable to emerging opportunities to buy attractive assets in Russia and therefore was temporary (investory.com.ua, March 23, 2009).

[4] It is not clear whether this was a new transaction or redistribution of control: previously 95% of shares was held by Vilmorin Holdings of Cyprus; Promyshlenniy Kontsern declined to comment on its affiliation to this company on account of commercial confidentiality (Interfax–Ukraine, July 29, 2009).

commented by Y. Tsukanov, Director of Link Development, "the building industry is in a miserable condition like no other: demand and prices collapsed together with credit, and prices for building materials hold so far. That is why construction assets are the first to be sold at "crisis" prices. So far, only Russians show interest in these acquisitions: they are ready for our [i.e. Ukrainian] risks" (Kommersant-Ukraine, September 22, 2009).

Setbacks were also observed in other sectors: for example, LUKoil cut investment in its petrol stations network in Ukraine (Blyakha, 2009). LUKoil's forthcoming investment in the Khvalynskoye oilfield and other oil & gas projects in Kazakhstan also came into question (Paramonov, Strokov, Stolpovsky, 2009).

In some instances the crisis produced complex effects. In October 2008, EuroChem acquired the government's block of shares in Sary-Tas (50.7%), establishing EuroChem-Udobreniya LLP to this end, and paid up the company's debt for fifteen years of standstill. Investment in this project is expected to total $2.5 billion by 2015. The facility, which has remained idle for many years, will be used as a basis for a new industrial complex comprising a mining and ore dressing works and three plants producing phosphate (1 million tons a year), nitrate (0.8 million tons) and combined (0.5 million tons) fertiliser. The company intends to finance this project exclusively from its own funds. Possibly, this sizeable initiative by EuroChem was inspired principally by the favourable situation on the global mineral fertiliser markets in the pre-crisis period (which enabled to company to accumulate enough liquidity to support its investment programme even after the outbreak of the crisis) and lower cost of electricity and labour in Kazakhstan (RBC Daily, October 10, 2008).

But EuroChem's other projects in Kazakhstan were delayed due to the crisis. In February 2009, the company asked the Kazakh government to refrain from putting out to tender the Araltobe and Kestiktobe phosphate deposits (in which the company showed interest in 2008), so as to allow it to return to this matter later, when the situation on the phosphate fertiliser and capital markets improves (Ekspert, March 4, 2009; Novyie khimicheskiye tekhnologii, March 4, 2009). EuroChem finally secured mining rights in respect of these two deposits plus Gimmelfarbskoye in June 2010. However, according to V. Torin, Head of PR & Communications at EuroChem, this delay was due not only to the crisis but also bureaucratic procedures: "the project is fairly big, and unnecessary rush may play a negative role. Support from authorities at all levels and prompt decision-making will be critical to implementation." (Kursiv, July 1, 2010). It is not really possible to say to what extent the delay was attributable to the crisis or political and bureaucratic reasons. From the very beginning, the Sary-Tas project was positioned as CIS-oriented, and the three abovementioned deposits are intended to support sales in Kazakhstan or, if domestic demand is not sufficient, elsewhere.

Later in 2008-2010 Russian companies implemented a number of large projects in the CIS (this list is less impressive than several years ago; in many cases these were the completion of projects from previous years rather than new ones). In June 2009, Polymetal acquired 100% in the Varvarinskoye gold and copper deposit in Kazakhstan (Three K Exploration and Mining Ltd) from Orsu Metals of Canada (vesti.kz, June 17, 2009). As the company announced, this transaction reached up to $20 million. TNC-BP purchased two oil bases and 36 petrol stations in Kyiv Oblast and the city of Kyiv from Gepard Group, and now intends to further expand this petrol stations network in Ukraine (covering Dnepropetrovsk and Donetsk). Vimpelcom acquired 7% of shares in the cellular operator Unitel in Uzbekistan, thus securing 100% control over the company (Starostenkova, 2010). Just prior to the crisis, in June 2008, TMK Group was joined by KMK-Kazakhstan, manufacturer of compressor pipes and casing tubing for the oil & gas industry. In autumn of 2008, the construction company Promstroi Group completed acquisition of Kazmekhanomontazh and Avtomatika of Kazakhstan (this evidences the stability of investment activity of small TNCs in crisis time, see Kuznetsov, 2009).

Despite the crisis, Russian investors were expanding their presence in Ukraine's metallurgy. In September 2008 EVRAZ completed the acquisition of Palmrose Ltd (Sukhaya Balka and Petrovsky Dnepropetrovsk Metal Works; shares in Bagleikoks, Dneprokoks and Dneprodzerzhinsk Charred Coal & Chemical Plant) from Privat group that was initiated in April 2008. The total cost of this transaction exceeded $2 billion. In December 2009 a group of Russian investors affiliated with shareholders of Metalloinvest and EVRAZ purchased the controlling block of shares in Industrialny Soyuz Donbassa (ISD). This transaction also exemplifies the complex effects of the crisis: according to available information, in 2008 EVRAZ and ISD were about to complete the transaction, but the progress halted as the crisis started to manifest itself. However, in a year the Russian investors managed to form a large pool (the total transaction amount was $2-2.5 billion, and was financed by Vneshekonombank). In other words, investment recession did take place, but it resulted in temporary suspension of investments rather than repudiation of the project. It is also presumed that the asset was sold at a material discount (due to its indebtedness), which can also be viewed as evidence of replacement growth (Kommersant, January 11, 2010; Bankir, January 17, 2010).

Another transaction that has been negotiated since 2008 and continued into the crisis period is the acquisition of KazakhGold of Kazakhstan by Polyus Gold. This transaction deserves closer attention due to its importance.

KazakhGold Group owns Kazakhaltyn, a major Kazakh gold producer, which operates three largest gold mines. The company's principal shareholder was the Asaubayev family. Since 2005, KazakhGold's shares have been traded on the London Stock Exchange (LSE). In November 2008, the Kazakh Ministry of Energy and Mineral Resources permitted Polyus Gold to buy 50.1% of shares in the company (under Kazakh law, the state has the pre-emptive right in such cases); and in September 2008 the company's value was estimated at $746 million (BFM.ru, November 17, 2008). In June 2009, the transaction was officially closed and announced on the LSE: Polyus Gold acted as guarantor under KazakhGold's $200-million bond issuance with maturity in 2013, and also provided KazakhGold with two loans for a total of $100 million. In June 2010, Polyus Gold announced a reverse takeover that would enable it to register in a foreign jurisdiction and access the LSE (finam.ru, June 30, 2010).

But in 2010 it became clear that KazakhGold's financial statements published by its former owners were materially misleading: its asset value was overstated by 14% and profit by 40%, and net loss was understated by 163% (Kursiv, March 26, 2010; MAonline, July 1, 2010). The Russian party filed a claim with the High Court in London demanding the former owners pay $450 million in damages. In July 2010, the Kazakh government declared that the transaction would be revised on account that Polyus Gold had allegedly paid much less for KazakhGold than the initial assessment of $269 million. The permit for selling KazakhGold shares to Polyus Gold was cancelled, and the Kazakh Ministry of Industry and New Technology forbade Kazakhgold to issue additional shares to Polyus Gold. In conjunction with that, a media campaign against the Russian company was staged in Kazakhstan. Experts believe that this hostile about-turn was provoked by legal action against the Asaubayev family who have close ties with the Kazakh elite. This transaction is very illustrative of risks associated with attempts to enter non-transparent post-Soviet economies (Evrasia Internet, August 10, 2010). On the other hand, the potential for trouble was already there when Polyus Gold's omitted to do any due diligence prior to the transaction – presumably, in an attempt to outstrip the other bidder, Zijin of China (Gornopromyshlenniy portal Rossii, August 9, 2010).

In October 2010, Polyus Gold and KazakhGold admitted that they reached deadlock and the merger process could not be finalised by October 29, 2010, i.e. the proposed closing date of reverse takeover (RBK, October 26, 2010). However, in December 2010, Polyus Gold and the Asaubayev family (AltynGroup Kazakhstan LLP) compromised on the sale of all Polyus Gold assets in Kazakhstan, Kyrgyzstan and Romania to AltynGroup for $509 million (payable in two instalments until March 11, 2011 and June 8, 2012). According to available estimates, this transaction only covers the cost of acquisition of KazakhGold in 2009, but does not compensate Polyus Gold for investments made in KazakhGold or any associated damage. Ultimately, the Russian investor will acquire the parent company KazakhGold without assets, which can be used as a vehicle for listing on the LSE (through reverse takeover) and then, possibly, merger with a large international gold producer. In other words, the KazakhGold transaction was reduced from an investment project designed as part of expansion in the post-Soviet space to a mere technical procedure of accessing international financial markets (the latter issue is still up to the Kazakh government which has to restore the revoked permit for Polyus Gold to buy KazakhGold shares) (Fincake, December 8, 2010).

Polyus Gold's transaction exemplifies the standard philosophy of post-Soviet business expansion (i.e. reliance on non-transparent arrangements and the manner in which external competition risks are handled), but, for the purposes of our study, it is primarily an example of how a Russian investor completed a promising acquisition that it had deemed strategic in the face of the crisis. Moreover, no crisis developments could make the acquisition of the desired assets by Russian TNC more prudent. Despite the global crisis, the TNC was conducting business as usual, and with a great deal of post-Soviet specific features at that.

Financial sector transactions

More interesting observations can be made on some landmark transactions in the financial sector.

The transactions under review were clearly dictated by economic recession in post-Soviet countries. They allow us to study the role of a political agenda (at least potential) behind them. Remarkably, these two transactions in the banking sector had similar background but brought about very different results, and this adds interest to our comparative analysis (we can even talk about compliance with the most similar different outcomes criterion which is used in comparative studies in social sciences).

One of the uncompleted transactions negotiated in 2009 was an inconclusive attempt by Sberbank at buying Bank TuranAlem (BTA) of Kazakhstan. This investment initiative in itself exemplifies the logic of replacement growth: BTA, one of the backbone Kazakh banks, was put up for sale solely due to the serious problems caused by the first tide of the global crisis. In view of the bank's financial troubles, the Kazakh government resorted to partial nationalisation: 75.1% of BTA shares were purchased by the public holding company Samruk-Kazyna (this contradicted the general government line in banking sector management of the recent two decades which was based on the flat premise of private sector domination). The government announced that its shareholding in the bank would be temporary, 3-5 years at most.

The search for potential buyers began, and Russian Sberbank (which already had a subsidiary bank in Kazakhstan) was most favoured, especially in view of the recent admission of Samruk-Kazyna's head Kairat Kelimbetov to the Supervisory Board of Sberbank in the summer of 2009. On June 2, 2009, Anvar Saidenov, Chairman of BTA, announced that the bank had received a single official bid from Sberbank. Earlier, in April, news came of Sberbank doing a due diligence exercise in the respect of BTA and negotiations over purchase of all Samruk-Kazyna's share. In his interview to Kommersant (Kommersant, June 3, 2009), German Gref, President of Sberbank, said that he was awaiting the completion of the restructuring of BTA (whose foreign debt was estimated at $13 billion) and execution of all investment agreements, after which he would consider buying the shares.

However, by autumn of 2009, it was rumoured that Sberbank would refuse to buy BTA due to the latter's poor standing. Observers were speculating about the political aspect of the negotiations, which is relevant to our study, i.e. the stance of the Russian government that was interested in the transaction (of course, acquisition of BTA would be very opportune in the context of the new wave of talks over closer regional integration). Overall, the word is that the political agenda is unlikely to force Sberbank into a clearly uneconomic deal, and the most probable future scenario is "endless talks" without flat refusal (Respublika, September 4, 2009). Finally, in October 2009, BTA signed a memorandum of understanding with a creditors committee on restructuring, which granted the creditors long-term control over the bank, thus making the chances of acquisition even fainter (Zarschikov, 2009).

The second similar project in the banking sector was more successful. In December 2008 – January 2009 (i.e. much earlier, during a more acute phase of the crisis) Vneshekonombank purchased Ukrainian Prominvestbank. This transaction has much in common with the inconclusive BTA transaction. Prominvestbank was founded in 1992 on the basis of former Prominvestbank of the Ukrainian Soviet Socialist Republic, and in 2008 ranked sixth in Ukraine in terms of assets. Massive withdrawal of private deposits in the autumn of 2008 (which totalled $1 billion in the first week of October alone) forced the National Bank of Ukraine to introduce provisional administration in Prominvestbank (for the first time in the country). Apparently, this decision was dictated not only by the crisis but also a raider action in 2008 allegedly backed by Russian players (Advisers, March 13, 2010). The search of a potential strategic investor was made in a desperate rush (according to Vladimir Krotyuk, interim administrator and Deputy Chairman of the National Bank of Ukraine, bids from western financial institutions were turned down on account that they requested several months for the decision-making process; see Prostobankir.co.ua, March 4, 2010). Potential buyers included individual investors and private and public banks from Russia and Ukraine (Sberbank, NRB and Alfa Bank were all mentioned). Eventually, Vneshekonombank won and invested 1.1 billion hryvnias ($158 million) in Prominvestbank's charter capital. Another 7 billion hryvnias was provided in long-term loans. Vneshekonombank acquired 75% +3 shares in Prominvestbank. On February 10, 2009, Vneshekonombank transferred to Prominvestbank the first $390 million from a subordinated loan, and a week later Prominvestbank announced that its operation stabilised.

Vladimir Dmitriyev, Chairman of Vneshekonombank, said that until recently the bank had not seriously considered entering the Ukrainian market, concentrating instead on internal reform and creation of a development bank. But eventually that step was made despite the difficult financial position of the acquired bank and the little promise Ukraine's banking sector offers at the moment (NewsRu.ua, December 21, 2009). Vneshekonombank's head explains the choice of Prominvestbank by the role it plays in lending to the Ukrainian industry: it has a large number of clients, and many of them have close ties with Russian manufacturers. Vneshekonombank intends to use Prominvestbank for adjusting settlement with Ukraine (UGMK, April 1, 2009). It is also planned to make the bank one of Ukraine's top five (RBK-Ukraine, March 5, 2009). Vneshekonombank received a bid to purchase Prominvestbank from Slav AG owned by the Ukrainian politicians and businessmen Sergei and Andrei Klyuyev who also hold shares in Prominvestbank (they were among the potential buyers of the controlling block of shares). Vladimir Dmitriyev jokingly comments that this acquisition was made out of "proletarian internationalism", meaning that at that difficult time neither private nor public Russian banks had resources necessary for rehabilitation measures[5].

As we have mentioned above, this transaction closely resembles Sberbank's BTA project, but there are two material distinctions. First, Vneshekonombank as a public corporation can be expected to be far more politically motivated. Second, Vneshekonombank's overseas platform is no match for that of Sberbank, although it has a subsidiary in Belarus (since the Soviet period). Therefore, we cannot discard either motive for investment expansion: replacement growth (taking advantage of the critical condition of a potentially lucrative asset, since the transaction was made at the very peak of the crisis) and political interests (which, however, are always important to Vneshekonombank irrespective of the crisis). It is likely that the commercial and political considerations were both present in this case.

Comparing the BTA and Prominvestbank projects allows us to make several observations. Russian banks (especially government-owned ones), heavily injected with public funds during the crisis, were well positioned to embark

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[5] *Interview of Vladimir Dmitriyev at Prominvestbank's website, www.pib.com.ua/pr/biznes 20090608.php.ru, 12.08.2010.*

on buying up crisis-stricken assets in CIS countries in accordance with the replacement growth scenario. In many cases they took a very prudent stance on the emerging opportunities, carefully selecting truly promising assets. And in some cases, by contrast, they took fairly high risks. Government control, albeit formal, does not necessarily mean that political considerations will prevail, even in crisis conditions; this depends on the government's part in an individual company.

Some illustrative crisis-time transactions related to the stock market infrastructure. Notably, before the crisis cooperation between stock exchanges and depositories from different CIS countries was rather formal and hardly went beyond memoranda of understanding or membership of business associations (The International Association of CIS Stock Exchanges and the Association of Central Depositories of Eurasia) (Golovnin, 2009). However, the Moscow Interbank Currency Exchange (MICEX) often assumed an active role in promoting financial integration initiatives.

The crisis changed the situation dramatically, especially as concerns cooperation between Russian (RTS) and Ukrainian stock exchanges (Golovnin, 2010). Earlier, Russian stock exchanges have made several inconclusive attempts at entering the Ukrainian market through joint projects with local infrastructure organisations. Finally, at an early stage of the crisis (in May 2008) the RTS launched the Ukrainian Stock Exchange jointly with Ukrainian players (this time, we can refer to a "brand new" investment rather than acquisition of an existing asset). Trade on the new exchange opened in March 2009; for the first time in Ukraine, Internet trading facilities were introduced, which at once elevated the new exchange to a leading position and wrecked the monopoly of the First Stock Trading System (FSTS). Notably, the latter had grasped the threat at an early stage, and in June 2008 secured the supply of a new trading platform (also capable of supporting Internet trading) by the MICEX. However, the FSTS failed to outstrip its competitor in launching the new system (this was done in April 2009). As a result, the FSTS lost its position permanently and started to consider selling shares to a foreign strategic investor. According to the FSTS management, the only response to the offer came from the MICEX (Investgazeta, January 25, 2010). In December 2009, the management approved the sale of 50% + 1 share to the MICEX, and the transaction was closed in mid-2010.

Thus, the main part of Ukraine's stock market infrastructure came under the control of Russian capital, including government-owned structures (the principal shareholder of the MICEX is the Central Bank of Russia).

The above two transactions, especially the MICEX's FSTS project, fit the replacement growth scenario. In addition, investments by the Russian stock exchanges are clearly strategic in essence, whereas

Vneshekonombank will most probably sell its Ukrainian asset that does not fully correspond to its core business (and most probably to another Russian player). These transactions pave the way for future financial cooperation between post-Soviet countries, and success of this cooperation will largely depend on Russian stock exchanges' performance in Ukraine. The first upgrade to the national infrastructure has been already made (the launch of Internet trading).

The crisis and entering global markets

There are also a number of other examples of how Russian businesses took full advantage of the crisis conditions to improve their international standing. In this case we refer not only to expansion in the CIS but also the associated asset diversification processes. In June 2009, Atomredmetzoloto (ARMZ), a member of Rosatom, secured a strategic alliance with Uranium One of Canada. The company exchanged its 50% stake in the Karatau deposit in Kazakhstan (the remaining 50% is held by Kazatomprom) for 16.6% of additionally issued shares in Uranium One plus $90 million (the latter amount may increase by $60 million depending on Karatau's performance in the next three years). The Canadian party was granted the pre-emptive right to buy ARMZ assets outside Russia (obviously, Uranium One is chiefly interested in Kazakhstan). ARMZ became the first strategic investor in formerly public Uranium One. Thus, ARMZ secured itself access to Uranium One's global resources scattered over several continents (ARMZ's own resources in Russia are very costly to operate due to the harsh climate) (Ekspert, June 16, 2009). ARMZ also strengthened its presence in Kazakhstan where Uranium One operates a number of deposits (Akdalinskoye and Yuzhno-Inkaiskoye (70%) and Kharasanskoye (30%)) that can be developed at a fabulously low cost.

Bearing in mind that in June 2010 ARMZ increased its share in Uranium One to at least 50%, this transaction holds even greater promise for the Russian party. It appears that the crisis forced Russian companies to seek expansion beyond their priority target regions of Europe and the CIS. In this particular case, however, internal political developments in Kazakhstan played a role: some time ago Uranium One became involved in a major scandal (the so-called "Dzhakishev case") relating to unlawful privatisation of a number of uranium deposits. Experts believe that the transaction with ARMZ will provide Uranium One with a degree of protection in Kazakhstan. The latter consideration becomes even more important in view of the fact that the proposed sale of about 20% of shares in Uranium One to Toshiba has not so far been authorised by the Kazakh government (although Toshiba was not refused flatly and, according to its Vice-President Yasuharu Igarashi, is already participating in Uranium One's operation; the approval process lasts beyond reason) (Kursiv, June 10, 2010).

Conclusions

Although the cited information is largely incomplete and non-systematic, we can draw certain conclusions. Kazakh companies, one of the two investment forces in the CIS, have acted generally in accordance with the investment recession scenario. Therefore, the formation of the CIS' second integration core in this country is open to question (Vinokurov, Libman, 2010). In this respect, however, the Kazakh government and TNCs will have the final word.

The situation with Russian TNCs is not as simple. Evidence of investment recession, i.e. suspension of announced projects and a decline in the number of new initiatives, is in place. However, not all developments in Russia speak in support of the investment recession hypothesis: later in 2008-2010, Russian TNCs completed several sizable transactions (it does not matter that most of them had been initiated in the pre-crisis period). In other words, Russian investment activity in CIS countries and elsewhere proved resistant to the crisis. Notably, most of the projects suspended in the autumn of 2008 were finalised in 2009, when the peak of the crisis was over (e.g. in metallurgy and mining).

We have also found evidence of replacement growth, first of all in the financial and banking sectors (and, partially, in construction and metallurgy); but the outcomes of the reviewed projects were different. The replacement growth logic was clearly visible in projects to diversify the overseas assets of Russian TNCs and promote expansion beyond the post-Soviet space. In this case, however, complex interrelation between crisis developments and changes in the strategy of Russian TNCs makes the analysis of resulting effects a challenging task. In quantitative terms, the Russian share in total investments in those CIS countries for which data is available increased (the only exception was Kyrgyzstan), which also fits the replacement growth hypothesis.

The role of interstate cooperation in investment remained insignificant throughout 2008-2009. We have grounds for assuming that the warming of Russian-Ukrainian relations in the spring and summer of 2010 and inception of the Customs Union will give an added impetus to investment cooperation. However, since these changes in international relations coincided with economic recovery in Russia, it is difficult to put a simple valuation on this role. An analysis of the above assumption will only become possible in a few years. A political agenda may have exerted certain influence in some implemented and proposed transactions, but the degree of this influence should not be overstated.

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Foreign Trade in CIS Countries During the Economic Crisis*

3

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The macroeconomic fallout of the global economic crisis in CIS countries

As we have discussed previously (Golovnin, Ushkalova, Yakusheva, 2010; Libman, Golovnin, 2010), the economic impact of the current global crisis became fully apparent in developed countries in the second half of 2008. Signs of stagnation had appeared at the end of 2007, but in the wealthiest economies, real gross domestic product (GDP) dynamics remained on a positive trajectory into the last quarter of 2008. In the United States, for example, real GDP dropped by 0.3% in the third quarter of 2008 (compared to the same period of the previous year) and by 2.8% in the following quarter. In Germany and throughout the European Union (EU), economic stagnation began in the third quarter of 2008 (with GDP growth rates of 0.5% and 0.1%, respectively), and the next quarter saw notable falls of 2% and 2.1%, respectively. In developed countries the crisis was at its peak during the first three quarters of 2009, and only in the fourth quarter of that year were the early shoots of a revival observed in the US, and the decline in GDP in the EU began to slow down. The first three quarters of 2010 saw sustained upward development. However, the benchmark used, i.e. the peak of the crisis period, is quite low[1]. Therefore, assessment of the subsequent dynamics of these developed economies remains inconclusive.

The crisis spread from developed economies to developing ones mainly via two channels: the contraction and even inversion of capital flows; and the contraction of aggregate demand in developed countries. The latter channel involved a reduction in exports from developing countries to developed countries and the reduction of revenue from factors of production of developing countries working in developed countries, chiefly migrant labour. In this study, we focus principally on the contraction of aggregate demand.

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[1] *Based on OECD data (www.oecd.org).*

If we examine the crisis dynamics in CIS countries using GDP and industrial production data (see Tables 3.1 and 3.2), we can identify several distinct models. When looking at the timing of real GDP slowdown, the countries divide into three distinct groups, as follows:

1) in Kazakhstan, Russia and Ukraine a sustained downward trend began in the second quarter of 2008, although economic growth rates remained fairly high;

2) Azerbaijan joined these economies in the third quarter of 2008 and Armenia and Belarus in the fourth quarter; and

3) in Kyrgyzstan, Moldova and Tajikistan, GDP started to decrease in early 2009 and reached its nadir almost at once.

In contrast, industrial production dynamics suggests an earlier and simultaneous exposure to the crisis: industrial production rates started to slow down in Armenia, Belarus, Moldova, Russia and Ukraine in the second quarter of 2008 and in Azerbaijan and Kazakhstan in the third quarter (following a collapse in the price of oil, these countries' staple export). The two exceptions were Tajikistan, where industrial production started to fall in early 2008, and Kyrgyzstan, where the crisis hit only in early 2009; up to that point, considerable world demand for gold had been compensating for the country's declining industrial production.

Table 3.1.
Real GDP dynamics (% of the same period of the previous year)
Source: CIS Interstate Statistics Committee (www.cisstat.com)

	2008				2009				2010	
	January-March	January-June	January-September	January-December	January-March	January-June	January-September	January-December	January-March	January-June
Azerbaijan	113.8	116.5	115	110.8	104.1	103.6	106.1	109.3	105.4	103.7
Armenia	113	110.9	113.1	106.9	93.9	86.7	83.5	85.8	105.5	106.7
Belarus	111.3	110.9	111.2	110.2	101.1	100.3	99.7	100.2	104	106.6
Kazakhstan	106.1	105.7	104	103.3	97.8	97.6	98.5	101.2	107.1	108.5
Kyrgyzstan	106.7	107.7	107.2	108.4	98.7	98.2	101.2	102.3	116.4	105
Moldova	104.3	105.4	107.6	107.8	93.1	92.2	92.3	93.5	104.7	105.6
Russia	109.3	108.4	107.7	105.6	90.5	89.8	90.7	92.1	102.9	104.2
Tajikistan	103.2	105.8	107.2	107.9	103.5	102.8	102.7	103.4	106.8	107.4
Ukraine	108.5	106.2	104.3	102.3	79.8	82.2	84	84.9	104.9	106

In most countries a decrease in real GDP was first recorded in the first quarter of 2009 and the crisis reached its peak in the second and third quarters. Thus, there was a time lag of approximately one calendar quarter between the moment when the crisis struck developed economies and when it spilled over into developing ones. Industrial production data paints a similar

	2008				2009				2010	
	January-March	January-June	January-September	January-December	January-March	January-June	January-September	January-December	January-March	January-June
Azerbaijan	112.9	113.8	112	106	97.8	101	105	108.6	105.6	103.5
Armenia	100.2	99.8	103.4	102	90.5	88.5	88.6	92.2	110.4	112.3
Belarus	115.2	113.6	113.4	111.5	96.1	96.9	96.2	98	105.9	108.8
Kazakhstan	103.7	103.8	103	102.1	95.4	97.3	99	102.7	111.5	111
Kyrgyzstan	104.7	106.5	109.5	114.9	80.8	81.2	88.6	93.6	178.8	141.8
Moldova	107.7	104.6	102.8	100.7	75.8	75.1	75.7	77.8	104.9	106.6
Russia	106	105.2	104.1	100.6	84.5	85.5	87.1	90.7	109.5	110.2
Tajikistan	89.9	96.1	97.5	96	91.8	86.7	90	93.7	116.3	112
Ukraine	105.7	104.5	102.5	94.8	68.2	69	71.7	78.1	110.8	112

Table 3.2.
Industrial production dynamics (% of the same period of the previous year)

Source: CIS Interstate Statistics Committee (www.cisstat.com)

picture but suggests a more profound and protracted impact straddling the first three quarters of the year. Economic growth rates accelerated in Azerbaijan and Kyrgyzstan in the third quarter of 2009 and in Kazakhstan and Tajikistan at the end of 2009; in the other CIS countries growth rates started to gather momentum only in 2010. Industrial production dynamics became positive in Kazakhstan and Azerbaijan in 2009 (due to rising world oil prices) and in the rest of the CIS in 2010.

In GDP terms, the crisis dynamics witnessed in Russia was reflected in Kazakhstan, Ukraine and to a lesser extent Moldova. Russia's industrial production trends during the crisis were mirrored in Armenia, Belarus, Moldova and Ukraine. These similarities can be explained both by external factors, i.e., for Kazakhstan the fall in energy prices and for Ukraine and Moldova a drop in demand from the EU and the countries' close economic interdependence.

The different groups of CIS countries were exposed to the crisis in different ways[2]:

1) the dual impact of the crisis on net exports and investments, particularly in Russia and Ukraine. Armenia also falls into this group, although a decline in its net exports was not as dramatic since imports also declined;

2) the impact on net exports, where investment continued to have a positive effect on GDP even though these were lower for most of the period. This group includes Belarus;

[2] *Classification based on quarterly data from the EurAsEC+ Economic Review (2009) and CIS Economic Review (2010) and EBRD annual statistics (www.ebrd.com).*

3) the impact on household consumption. This would not normally be seen as a manifestation of the effects of a crisis as it is consumption that is least susceptible to economic fluctuation. However, effects on consumption were observed in Kyrgyzstan (2009);

4) the shifting impact on different components of GDP. For example, the negative impact on GDP in Kazakhstan was chiefly a result of the crisis influence on net exports in the first and third quarters of 2009, net exports and investments in the second quarter of 2009, and household consumption in 2008 and the fourth quarter of 2009. In Moldova, the impact on net exports in 2008 shifted to consumption and investments in 2009.

Exchange rate dynamics also merit closer attention in our analysis of foreign trade (see Table 3.3).

All CIS countries were subject to a substantial devaluation of their national currencies against leading world currencies via the foreign trade and capital flow channels. The scale of these devaluations varied across the CIS, depending on objective factors and government monetary policies. Traditionally, economic crises are accompanied by so-called "competitive devaluations". However, the current crisis has proved that, although there may have been sizeable fluctuations in individual countries, on the whole, the devaluations of CIS currencies against the US dollar remained within comparable ranges. The countries whose national currencies appeared most resistant to the crisis were those of Azerbaijan (not surprisingly, in view of the country's good macroeconomic health), Moldova and Georgia. The Ukrainian hryvnia and the Belarusian rouble fared the worst. Devaluation rates in the other CIS countries averaged 18-21% between the first quarter of 2008 and the second quarter of 2010 except in Uzbekistan and Turkmenistan, where no uniform exchange rates exist. In other words, no significant competitive advantages were generated by these fluctuations during the crisis period.

However, at certain stages short-term advantages did exist as exchange rate dynamics varied over the period concerned. The first country to experience the devaluation of its currency was Kazakhstan in the third quarter of 2007, as it was the first CIS country to feel the impact of the global crisis. Kyrgyzstan followed in the first quarter of 2008, since its economy is heavily dependent on Kazakhstan. The Russian rouble started to fall in the third quarter of 2008 and most other CIS currencies in the fourth quarter of 2008. Currencies reached their lowest in the first quarter of 2009, but some countries (Belarus, Georgia, Kyrgyzstan and Moldova) suffered a second wave of devaluations in the first half of 2010, which may be interpreted as competitive devaluation in the context of improving macroeconomic conditions.

	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q2 2010 / Q1 2008
Azerbaijan	1	0.9	0.6	0.6	2.2	1.7	0.4	0.4	0.1	0	0.1	0	0	4.9
Armenia	1.5	4.8	6.5	2.9	0.3	1.6	-1.3	-5.9	-12.1	-0.6	-3.1	0.1	-0.1	-19.8
Belarus	-0.2	-0.1	-0.2	0.2	0.5	1	-1.5	-22.6	-0.8	-0.9	1.9	-4.8	-2.8	-28.2
Georgia	1.6	1.2	2.6	4.3	7.6	2.6	-9.3	-7.1	0.9	-1.2	-0.2	-2.5	-4.2	-13.4
Kazakhstan	2.8	-1.4	2	0.3	-0.1	0.5	-0.1	-13.5	-7.6	-0.2	0.6	1.4	0.6	-18
Kyrgyzstan	1	0.7	7.4	-2.8	-0.5	3	-8.6	-5.7	-5.2	-1.3	-0.2	-1.7	-2.6	-21
Moldova	3.7	3.2	5.5	2.3	8.0	5	-5.3	-2.4	-5.3	-0.2	-1.5	-9.3	-0.9	-12.3
Russia	1.7	1.4	3.5	1.6	2.7	-2.6	-11	-19.7	5.4	2.9	6.3	-1.5	-1.1	-19.8
Tajikistan	-0.1	-0.1	-0.4	-0.1	0.6	0.4	0.4	-7.2	-11.3	-5.7	0.6	-0.1	-0.1	-20.9
Ukraine	0	0	0	0	1.8	2.4	-21.9	-19.4	0.6	-2.1	-2.2	0	0.8	-36.3

Table 3.3.
Appreciation/devaluation of CIS currencies against the US dollar (in % of the previous period)

Source: International Financial Statistics Database (http://www.imfstatistics.org/imf/).

Foreign trade dynamics in the CIS during the crisis

The global crisis hampered the expansion of CIS countries' foreign trade, having caused a sudden, profound and simultaneous collapse of foreign trade worldwide (Baldwin, 2009). In most CIS countries the first signs of the crisis manifested themselves in foreign trade in the third quarter of 2008, and in the fourth quarter the values of exports to CIS and remote markets collapsed[3]. It should be noted, however, that export dynamics in the pre-crisis and crisis periods varied significantly from one CIS economy to another.

The impact of the crisis on foreign trade was first felt in Belarus, Georgia, Tajikistan and Uzbekistan. According to the IMF, total export volumes in these countries started to decline in July 2008. In Uzbekistan and Tajikistan this decline was largely attributable to a reduction in the value of raw cotton exports to remote markets. Exports from Belarus and Georgia declined as a result of the decrease in demand in Europe.

In most CIS countries (Azerbaijan, Armenia, Kazakhstan, Moldova, Russia, Turkmenistan and Ukraine) total export volumes started to decline in August 2008. For the CIS fuel and energy exporters, i.e. Azerbaijan, Kazakhstan, Russia and Turkmenistan, this contraction was caused by a fall in oil prices in July. A decline in industrial production in developed countries seriously impacted upon Ukraine's exports, since this country's staple commodity exports are metals and metallurgical products. Moldova, whose exports are dominated by agricultural produce, also started to feel the effects of the global crisis in August 2008, particularly on its extensive trade with Western Europe. However, the rate of its decline in exports was well below that of raw material and metal exports.

Kyrgyzstan, whose main exports are gold and rare-earth metals, was the last CIS country to suffer the macroeconomic impact of the crisis on its exports. In July 2008 its total exports fell by 2% compared to the previous month due to a reduction in exports to remote markets and, more significantly, falling cotton prices. This trend was at its most stark in December 2008, when investors put their trust in gold to see out the crisis and gold prices consequently increased.

The export dynamics of the different CIS economies were not uniform. Russia, Kazakhstan, Turkmenistan and Ukraine witnessed an unbroken decline from August 2008 to early 2009 (for Russia and Kazakhstan this continued until February 2009 and for Turkmenistan and Ukraine until January 2009). In the rest of the CIS, export volumes decreased less steadily. In Belarus, Georgia, Uzbekistan, Azerbaijan and Armenia total export volumes rallied in

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[3] Hereinafter, based on data from the IMF Directions of Trade Statistics Database (http://www2.imfstatistics.org/DOT/).

September 2008 (and in December in Azerbaijan), and then the downward trend resumed. A similar rise and fall in exports was recorded in Tajikistan in October-November 2008 and in Moldova in December 2008. For Kyrgyzstan's total exports, the picture was different again. In July-September 2008 the value of the country's exports was increasing. In September total exports increased by 4.2 times compared to August; in October they returned to the August level, but then rose again into November. In December 2008 exports began to decline. These oscillating patterns in some CIS countries reflected fluctuations in world prices for agricultural produce.

Exports to CIS and remote markets declined in most of the CIS countries almost simultaneously. In August 2008 a sustained downward trend in exports to CIS markets ended in Azerbaijan, Belarus, Russia and Ukraine. The decline in exports was dramatic in Armenia, but in September and October export volumes rose almost to July levels before falling again from November. A similar picture was observed in Turkmenistan and Uzbekistan: monthly intraregional export volumes dropped slightly in August, returned to the July level in September, and began to decline sharply again in October. Kyrgyzstan followed this rise and fall but with a delay of one month. In Georgia, this scenario started in July, but an abrupt downward trend developed fully only in November. In Kazakhstan and Moldova, a substantial decline in export to CIS markets began in October and November 2008, respectively, and in Tajikistan only in January 2009.

For most CIS countries, the export crisis was at its worst in January 2009, except in Belarus, Kazakhstan and Russia, where minimum monthly export volumes were recorded in February 2009, and in Azerbaijan in March 2009.

A recovery in CIS countries' total exports began in 2009, and in most countries (Azerbaijan, Armenia, Belarus, Georgia, Moldova, Tajikistan and Ukraine) the recovery was not a smooth one. Declines in monthly export volumes in these countries were caused primarily by price fluctuations on world commodity markets, and the dynamics of their exports to CIS markets typically followed the pattern of exports to remote markets. The only exceptions were Tajikistan where the crisis had little, if any, effect on exports to Russia and other CIS countries, hence both these indicators remained stable from early 2009 to early 2010. Azerbaijan's exports to CIS markets also showed uninterrupted growth in 2009.

Russia and Kazakhstan saw a gradual increase in total export volumes in 2009. Russia also increased its exports to CIS markets, whereas Kazakhstan's intraregional exports were in decline from October 2009 to January 2010.

The 2009 export dynamics for Turkmenistan, Uzbekistan and Kyrgyzstan need to be considered separately as it was subject to a particular set of circumstances. After the disruption of Russian natural gas exports to Ukraine following the Russian-Ukrainian gas conflict in January 2009, Turkmenistan boosted its gas supplies to Ukraine in February-March 2009 to over 90% of its total gas exports to CIS markets. Meanwhile, Turkmen gas supplies to remote markets remained at the very low levels reached in December 2008. On April 8-9, 2009, an accident occurred on the Central Asia-Centre gas pipeline in Turkmenistan, and gas supplies to Russia (including transit volumes) were discontinued[4]. Although the pipeline was repaired, Russia received no more Turkmen gas until January 9, 2010 owing to a dispute between the two countries over new supply terms. As a result, Turkmenistan saw an unprecedented decline in its exports to CIS countries and total exports in 2009. Formally, this decline had nothing to do with the global crisis, yet there are grounds for attributing Russia's reluctance to buy Turkmen gas to the global situation. The falling demand for gas from Gazprom's major customers such as Ukraine resulting from industrial stagnation made Russian and Turkmen gas producers direct competitors.

In parallel with this, in February-May 2009 Uzbekistan's exports to CIS markets increased, compared to monthly export figures in 2008, but in June 2009 Uzbek exports dropped to their lowest monthly total that year and started to rise again only in September 2009.

Export volumes to CIS countries and total export volumes in Kyrgyzstan increased from February 2009, and began falling again in September.

In most CIS countries (Armenia, Belarus, Georgia, Kazakhstan, Moldova, Russia and Ukraine) a decline in imports from regional and remote markets first manifested itself in August 2008 (see Figures 3.4-3.15 of the Annex). Monthly imports in Azerbaijan began to fall in September 2008, in Turkmenistan and Kyrgyzstan the fall came in October 2008[5], in Uzbekistan in November and Tajikistan in December.

Imports from regional and remote markets fell to their lowest in January 2009 in all CIS countries except Azerbaijan, Armenia, Russia and Kyrgyzstan. In Azerbaijan, Armenia and Russia the low point came in February 2009 (coinciding with the lowest oil prices) and in Kyrgyzstan in December 2008 (minimum imports from CIS markets were recorded in January 2009)[6].

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[4] The Ministry of Foreign Affairs of Turkmenistan blamed Gazprom for the accident. It was Turkmenistan's view that the accident has been caused by a sharp decrease in Gazprom's offtake of gas without sufficient notice to allow for changes to be made to the system's operating regime. Gazpromeksport delivered a letter about the reduced consumption to Turkmenistan on April 7, and began to reduce the taking of gas one day later on April 8. Therefore, the Ministry argues, the letter does not constitute prior notice, since the Russian side should have given at least one week's notice (Prime–TASS. April 10, 2009).

[5] A sharp increase in Kyrgyzstan's imports began in January 2009.

[6] Monthly IMF data (IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/).

The impact of the crisis on CIS countries' total foreign and intraregional trade

In comparative terms, the crisis had its most severe impact on exports in energy producing countries such as Turkmenistan and Azerbaijan, because of these countries' specific export structures and due to price fluctuation during the crisis (in case of Turkmenistan there were also other influences, as discussed above). According to the IMF, annual export values in Turkmenistan and Azerbaijan decreased by 70.5% and 69.2% respectively in 2009 compared to the previous year. The decrease was somewhat less dramatic in Kyrgyzstan (40.7%), Ukraine (40.6%) and Russia (38%). Moldova and Georgia felt the least impact on their exports (declines of 18.8% and 24.8% respectively). In the other CIS countries the decrease in exports averaged 30-35% (30.1% Tajikistan, 30.7% in Kazakhstan and Uzbekistan, 34% in Armenia and 34.7% Belarus)[7].

For the purposes of examining exports to CIS and remote markets we can divide CIS countries into two groups. In most CIS countries, especially Armenia, Kazakhstan, Moldova, Russia, Turkmenistan and Ukraine, exports to CIS markets dropped faster than exports to remote markets in 2009, compared to the previous year. In contrast, intraregional export was apparently more resistant to the crisis in Azerbaijan, Georgia, Kyrgyzstan, Tajikistan and Uzbekistan, and acted as a buffer against external shocks. In Belarus, exports to CIS and remote markets declined at approximately equal rates.

The impact of decreasing exports to CIS markets on the country's total exports[8] was most severe in Turkmenistan (total exports decreased by 47.1% in 2009 compared to 2008)[9], Belarus (15.4%), Ukraine (14.9%), Uzbekistan (14.1%) and Armenia (13.3%). The impact of decreasing export to CIS markets was less severe in Azerbaijan (fall of 0.2% in 2009 compared to 2008), Tajikistan (1.1%), Kyrgyzstan (2.9%), Kazakhstan (7.3%), Moldova (7.8%), Russia (8.4%) and Georgia (8.6%). On the whole, decreasing intraregional exports resulted in a 9.3% decrease in total exports by CIS countries in 2009 compared to the previous year.

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[7] Annual IMF data (IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/.

[8] In this case, we use the ratio (A) of the country's absolute exports to CIS markets in 2009 and 2008 (modulo) to its total exports in 2008: ($A=(EX^{CIS2009}-EX^{CIS2008})*100\% / EX^{2008}$, where $EX^{CIS2009}$ – exports to CIS markets in 2009, $EX^{CIS2008}$ – exports to CIS markets in 2008, EX^{2008} – total exports in 2008). This index A shows us how (in %) the decline of the country's exports to CIS markets in 2009 compared to 2008 influenced its total exports (i.e. what percentage of the decline in total exports is attributable to a decline in intraregional exports).

[9] Notably, the decline in Turkmenistan's intraregional exports was attributable mainly to disruptions of gas supplies to Ukraine in January and April–December 2009 (in the latter case, following the pipeline accident).

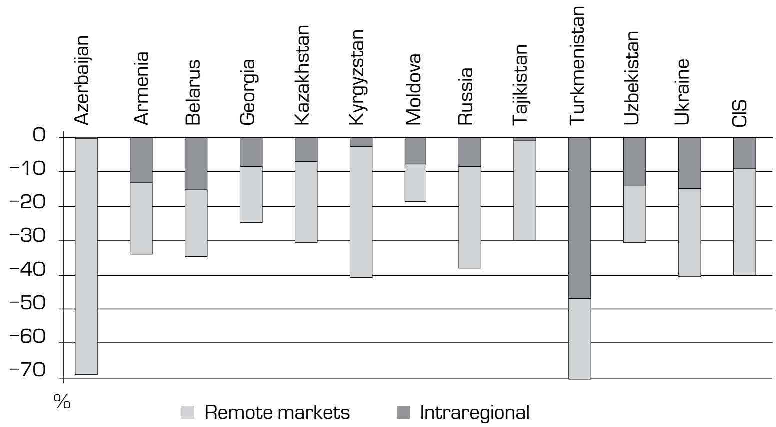

Figure 3.1. Contribution of the decline in exports to CIS and remote markets to the total decline in CIS exports (in 2009 compared to 2008)

Source: based on data from the IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/).

CIS countries can be divided into four groups depending on the role of the global or regional (secondary) channel through which the global crisis affected their commodity exports[10]:

1) countries affected principally by declining global demand and prices, whereas secondary (regional) effects were negligible (i.e. less than 10% of the decline in total exports was attributable to the decline in exports to CIS markets: Azerbaijan (0.3%), Tajikistan (3.7%) and Kyrgyzstan (7.1%);

2) countries in which the secondary (regional) effects of the crisis played a moderate role (20-39% of the decline in total exports was attributable to the decline in exports to CIS markets): Russia (22.1%), Kazakhstan (23.7%), Georgia (34.7%) and Ukraine (36.6%).

3) countries in which secondary (regional) effects of the crisis played a significant role (40-49% of the decline in total exports was attributable to the decline in exports to CIS markets): Armenia (40%), Moldova (41.8%), Belarus (44.5%) and Uzbekistan (46%);

4) countries in which secondary (regional) effects of the crisis played a decisive role (more than 50% of the decline in total exports was attributable to decline in exports to CIS markets): Turkmenistan (66.8%).

For five CIS countries secondary (regional) effects were the principal channel through which the crisis affected their export development, and for four countries these effects were significant.

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[10] *Classification is based on the contribution (A') of the decline in the country's exports to CIS markets in 2009 compared to 2008 to the decline in total exports in 2009 compared to 2008 (in %) (A'=($EX^{CIS2009}$–$EX^{CIS2008}$)*100% / EX^{2009}–EX^{2008}, where $EX^{CIS2009}$ – exports to CIS markets in 2009, $EX^{CIS2008}$ – exports to CIS markets in 2008, EX^{2009} – total exports in 2009, EX^{2008} – total exports in 2008).*

Generally, the decline in imports by CIS countries resulting from the crisis was on a scale comparable to that of the decline in exports. In comparative terms, the most dramatic declines in imports were observed in Ukraine (down by 46.9% in 2009 compared to 2008), Russia (39.8%), Moldova (33.1%), Georgia (31.3%), Belarus (27.5%) and Armenia (25.3%). In terms of value, imports dropped significantly in Kazakhstan (by 24.5%) and in Tajikistan (by 22.8%). The least severe decline in imports was observed in Azerbaijan and Uzbekistan (14.8% and 7.8% respectively). Imports increased by 22.3% in Turkmenistan and nearly doubled in Kyrgyzstan. The average decline in import values reached 35.4% in CIS countries in 2009.

In 2009 most CIS countries' imports from the region declined faster than imports from remote markets. The exceptions were Armenia, Tajikistan and Ukraine, where the situation was the reverse. Intraregional imports in Turkmenistan increased more slowly than imports from remote markets. There was a slight increase in imports from remote markets in Uzbekistan, whereas intraregional imports fell.

The impact of declining intraregional imports[11] on the country's total imports was especially pronounced in Belarus (a 19.6% decline in total imports in 2009 compared to 2008), Ukraine (16.1%), Kazakhstan (13.5%), Kyrgyzstan (13.1%), Moldova (12.2%), Georgia (11.8%) and Tajikistan (11.1%). This impact was less marked in Turkmenistan (intraregional imports increased by 1.8%), Armenia (a decrease of 5.1%), Azerbaijan (a decrease of 6.3%), Russia (a decrease of 8.5%) and Uzbekistan (a decrease of 8.2%).

CIS countries can be divided into five groups depending on the impact of declining intraregional imports on their total imports (i.e. resistance of intraregional imports to the effects of the crisis compared to imports from remote markets)[12]:

1) exceptions, i.e. countries in which intraregional import dynamics did not result in any decrease in their total imports: Turkmenistan (imports from CIS and remote markets increased) and Kyrgyzstan (an increase

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[11] *In this case, we use the ratio (B) of the country's absolute imports to CIS markets in 2009 and 2008 (modulo) to its total imports in 2008: (A'=(*$IM^{CIS2009}-IM^{CIS2008}$*)*100% /*$IM^{2008}$*, where* $IM^{CIS2009}$ *– imports from CIS markets in 2009,* $IM^{CIS2008}$ *– imports from CIS markets in 2008,* IM^{2008} *– total imports in 2008). This index B shows us how (in %) the decline of the country's imports from CIS markets in 2009 compared to 2008 influenced its total imports (i.e. what percentage of the decline in total imports is attributable to a decline in intraregional imports).*

[12] *Classification is based on the contribution (B') of the decline in the country's imports from CIS markets in 2009 compared to 2008 to the decline of total imports in 2009 compared to 2008 (in %) (B'=(*$IM^{CIS2009}-IM^{CIS2008}$*)*100% /* $IM^{2009}-IM^{2008}$*, where* $IM^{CIS2009}$ *– imports from CIS markets in 2009,* $IM^{CIS2008}$ *– imports from CIS markets in 2008,* IM^{2009} *– total imports in 2009,* IM^{2008} *– total imports in 2008).*

in imports from remote markets compensated for losses resulting from declining intraregional imports);

2) countries in which 20-25% of the decline in total imports was attributable to the decline in intraregional imports: Armenia (20.2%) and Russia (20.5%);

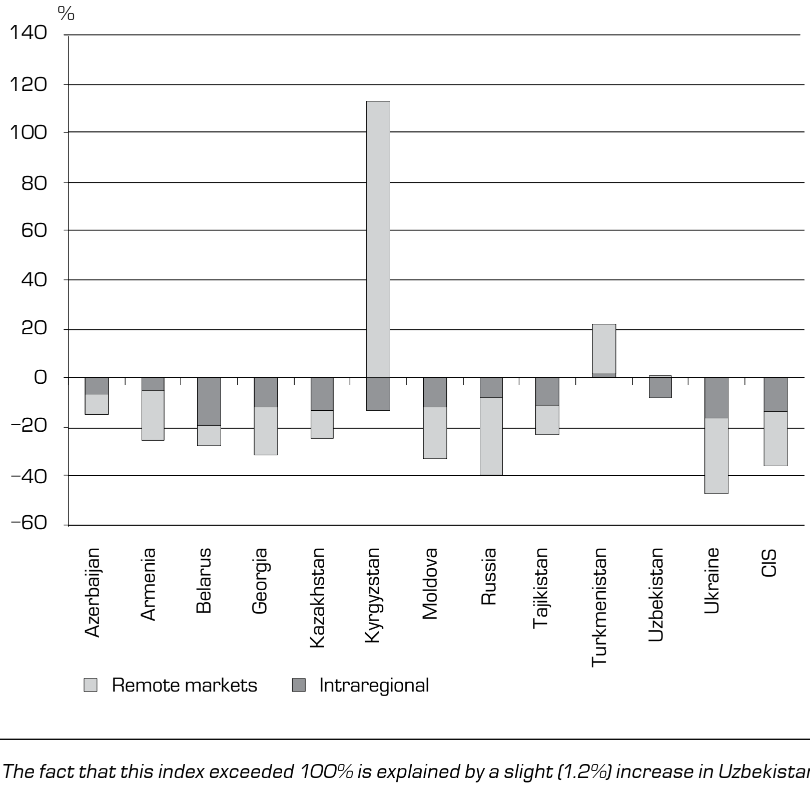
3) countries in which 30-40% of the decline in total imports was attributable to the decline in intraregional imports: Ukraine (34.4%), Moldova (36.9%) and Georgia (37.6%);

4) countries in which 40-50% of the decline in total imports was attributable to the decline in intraregional imports: Azerbaijan (43.5%) and Tajikistan (48%); and

5) countries in which more than 50% of the decline in total imports was attributable to the decline in intraregional imports: Belarus (71.4%), Kazakhstan (55.2%) and Uzbekistan (over 100%)[13].

Figure 3.2. Contribution of the decline in imports from CIS and remote markets to the total decline in CIS imports (in 2009 compared to 2008)

Source: based on data from the IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/).



[13] *The fact that this index exceeded 100% is explained by a slight (1.2%) increase in Uzbekistan's imports from remote markets in 2009 compared to 2008; as a result, the decline in intraregional imports was faster than the decline in total imports. Clearly, the decline in Uzbekistan's total imports was attributable solely to declining intraregional imports.*

In eight CIS countries the decline in intraregional imports accounted for more than one third of the total decline in imports.

To summarise the impact of the crisis on foreign trade (commodity export revenues) through different channels, we can also identify four country groups[14]:

1) countries in which secondary (regional) effects were negligible (i.e. the decline in commodity revenues from CIS markets accounted for not more than 2% of the total decrease in revenue: Azerbaijan (1.6%);

2) countries in which secondary (regional) effects of the crisis had a moderate impact (15-25% of the total decrease in revenue was attributable to the decline in commodity revenue from CIS markets: Kyrgyzstan (17.1%), Russia (21.5%) and Armenia (24.8%);

3) countries in which the secondary (regional) effects of the crisis had a significant impact (30-40% of the total decrease in revenue was attributable to the decline in commodity revenue from CIS markets): Moldova (37.6%), Georgia (37.2%), Kazakhstan (36.2%), Ukraine (35.3%) and Tajikistan (32%); and

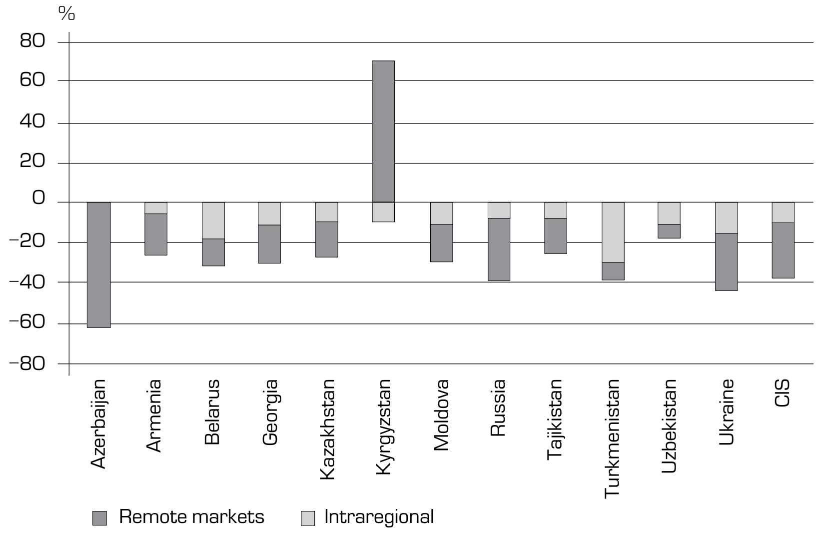


Figure 3.3. Contribution of the decline in intraregional turnover to the total decline in CIS turnover (in 2009 compared to 2008)

Source: based on data from the IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/.

[14] *Classification is based on the contribution (C) of the decline in the country's commodity turnover with CIS markets in 2009 compared to 2008 to the decline in total commodity turnover in 2009 compared to 2008 (in %) (T=($T^{CIS2009}$–$T^{CIS2008}$)*100% / T^{2009}–T^{2008}, where $T^{CIS2009}$ – commodity turnover with CIS markets in 2009, $T^{CIS2008}$ – commodity turnover with CIS markets in 2008, T^{2009} – commodity turnover in 2009, T^{2008} – commodity turnover in 2008).*

4) countries in which secondary (regional) effects of the crisis had a decisive impact (more than 50% of the total decrease in revenue was attributable to the decline in commodity revenue from CIS markets: Turkmenistan (78.7%), Uzbekistan (61.6%), Belarus (57.7%).

To better assess the impact of declining intraregional trade on the region's economies we should also consider the ratio of absolute decline in exports to CIS countries in 2009 (compared to 2008) to nominal 2009 GDP (in US dollars at the current exchange rate), and similar ratios calculated for intraregional imports and commodity revenues. If we apply the first ratio, CIS countries can be divided into four groups[15] (see Table 3.4):

1) countries in which their decline in exports to CIS markets was excessive relative to the size of their economy: Belarus and Ukraine (notably, both are among the largest CIS economies);
2) countries in which their decline in exports to CIS markets was significant relative to the size of their economy: Kazakhstan, Russia, Uzbekistan and Moldova;
3) countries in which their decline in exports to CIS markets was moderate relative to the size of their economy: Armenia, Georgia and Kyrgyzstan; and

Table 3.4.
Ratio of absolute decline in intraregional export in 2009 (compared to 2008) to nominal 2009 GDP

Source: based on data from the IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/); World Economic Outlook, October 2010).

Country	Ratio (%)
Belarus	10.3
Ukraine	8.5
Kazakhstan	3.5
Russia	3.1
Uzbekistan	3
Moldova	2.3
Armenia	1.6
Georgia	1.2
Kyrgyzstan	1
Tajikistan	0.3
Azerbaijan	0.2

[15] *Classification is based on the ratio (D1) of absolute decline in the country's exports to CIS markets in 2009 (compared to 2008) to nominal GDP (in US dollars at the current exchange rate) in 2009 (in %) (D1=($EX^{CIS2009}$–$EX^{CIS2008}$)*100% / GDP^{2009}, where $EX^{CIS2009}$ – exports to CIS markets in 2009, $EX^{CIS2008}$ –exports to CIS markets in 2008, GDP^{2009} – nominal GDP (in US dollars at the current exchange rate) in 2009). Turkmenistan is excluded from this classification due to the absence of reliable GDP data.*

4) countries in which their decline in exports to CIS markets was negligible relative to the size of their economy: Azerbaijan and Tajikistan.

Using a similar ratio calculated for the absolute decline in intraregional imports, CIS countries can be grouped as follows[16] (see Table 3.5):

1) countries in which their decline in imports from CIS markets was excessive relative to the size of their economy: Belarus, Ukraine, Kyrgyzstan and Moldova;

2) countries in which their decline in imports from CIS markets was significant relative to the size of their economy: Tajikistan, Georgia and Kazakhstan; and

3) countries in which their decline in imports from CIS markets was negligible relative to the size of their economy: Armenia, Uzbekistan, Russia and Azerbaijan.

Country	Ratio (%)
Belarus	15.8
Ukraine	11.7
Kyrgyzstan	11.7
Moldova	11
Tajikistan	7.2
Georgia	6.9
Kazakhstan	5.4
Armenia	2.7
Uzbekistan	2.4
Russia	1.8
Azerbaijan	1.1

Table 3.5.
Ratio of absolute decline in intraregional imports in 2009 (compared to 2008) to nominal 2009 GDP

Source: based on data from the IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/); World Economic Outlook, October 2010).

Using a similar ratio calculated for the absolute decline in intraregional commodity revenue, CIS countries can be grouped as follows[17] (see Table 3.6):

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[16] Classification is based on the ratio (D2) of absolute decline in the country's imports from CIS markets in 2009 (compared to 2008) to nominal GDP (in US dollars at the current exchange rate) in 2009 (in %) ($D2=(IM^{CIS2009}–IM^{CIS2008})*100\% / GDP^{2009}$, where $IM^{CIS2009}$ – imports from CIS markets in 2009, $IM^{CIS2008}$ – imports from CIS markets in 2008, GDP^{2009} – nominal GDP (in US dollars at the current exchange rate) in 2009). Turkmenistan is excluded from this classification due to the absence of reliable GDP data.

[17] Classification is based on the ratio (D3) of absolute decline in the country's commodity turnover with CIS markets in 2009 (compared to 2008) to nominal GDP (in US dollars at the current exchange rate) in 2009 (in %) ($D3=(T^{CIS2009}–T^{CIS2008})*100\%/GDP^{2009}$, where $T^{CIS2009}$ – commodity turnover with CIS markets in 2009, $T^{CIS2008}$ – commodity turnover with CIS markets in 2008, GDP^{2009} – nominal GDP (in US dollars at the current exchange rate) in 2009). Turkmenistan is excluded from this classification due to the absence of reliable GDP data.

1) countries in which the decline in intraregional commodity revenue was excessive relative to the size of their economy: Belarus, Ukraine, Moldova and Kyrgyzstan;

2) countries in which the decline in intraregional commodity revenue was significant relative to the size of their economy: Kazakhstan, Georgia, Tajikistan, Uzbekistan, Russia and Armenia; and

3) countries in which the decline in intraregional commodity revenue was negligible relative to the size of their economy: Azerbaijan.

Table 3.6.
Ratio of absolute decline in intraregional commodity revenue in 2009 (compared to 2008) to nominal 2009 GDP

Source: based on data from the IMF Directions of Trade Statistics, http://www2.imfstatistics.org/DOT/); World Economic Outlook, October 2010).

Country	Ratio (%)
Belarus	26
Ukraine	20.2
Moldova	13.3
Kyrgyzstan	12.7
Kazakhstan	8.9
Georgia	8.1
Tajikistan	7.5
Uzbekistan	5.4
Russia	4.9
Armenia	4.3
Azerbaijan	1.3

The results obtained allow us to draw general conclusions about the importance of regional trade channels for different CIS economies. Declining intraregional trade had the severest impact on Belarus, Ukraine, Moldova, Kyrgyzstan, Kazakhstan and Turkmenistan, and a lesser impact on Georgia, Tajikistan, Uzbekistan, Armenia and Russia. At the same time, the secondary (regional) effects of the crisis on foreign trade were very significant in practically all CIS economies, which indicates their strong interdependence. The only country which largely escaped the impact of the crisis on foreign trade through its own regional trade was Azerbaijan.

The impact of the global economic crisis on CIS export and import geography

The global economic crisis dramatically altered the geography of export and import operations by CIS countries, particularly the contribution of each individual country to the region's export and import structure. Essentially, whether or not the 2008 crisis will lead to a protracted decline in the contribution of intraregional trade to total CIS exports and imports (as happened during the Russian crisis in 1998), has been the key question for researchers interested in foreign trade and integration processes in the post-Soviet states.

According to the IMF, intraregional trade as a proportion of total commodity revenue did contract during the crisis period in most CIS countries. Intraregional exports increased [as a proportion of total commodity revenues?] in Azerbaijan, Kyrgyzstan, Tajikistan and Uzbekistan[18], whereas it decreased in the rest of the CIS (except Georgia) and on average in the region. Exports to CIS markets as a proportion of Georgia's total exports remained practically unchanged.

The share of intraregional import increased in Armenia, Tajikistan and Ukraine, and decreased in the rest of the CIS and on average in the region (see Table 3.7).

Table 3.7. Intraregional exports and imports as a proportion of total exports in CIS countries in 2008–2010 (%)

Sources: * calculated based on IMF data; ** data from the CIS Interstate Statistics Committee.

	Intraregional exports as a proportion of total exports in CIS countries				Intraregional imports as a proportion of total imports in CIS countries			
	2008*	2009*	1st half of 2009**	1st half of 2010**	2008*	2009*	1st half of 2009**	1st half of 2010**
Azerbaijan	3.4	10.4	6.1	9.8	32.7	30.8	30	31.9
Armenia	30.9	26.8	19.6	17	29.6	32.8	32.4	30.9
Belarus	44.1	43.9	43.7	53.2	65.9	63.8	63.6	61.1
Georgia	36.2	36.7	–	–	31.7	29.1	–	–
Kazakhstan	19.4	17.4	18	13.7	42.5	38.4	42.8	48.4
Kyrgyzstan	47.8	75.8	38.3	28	53.7	20.4	55.6	56
Moldova	39.4	38.9	35.7	38.3	35.5	34.9	37.4	32.1
Russia	13.8	8.8	15.6	14.1	13.7	9.2	12.8	15.2
Tajikistan	15.6	20.8	22	13.1	56.5	58.8	55.2	55.7
Turkmenistan	57.1	34	–	–	30.1	26.0	–	–
Uzbekistan	56.7	61.4	–	–	43.1	37.5	–	–
Ukraine	35.6	34.9	33.7	35	39.3	43.6	43.6	43.9
CIS average	18.4	15.2	18.9	17.4	27.4	25.4	27.8	28.2

[18] The increase in the proportion of CIS exports in the export structure of Azerbaijan, Kyrgyzstan, Tajikistan and Uzbekistan had different causes. In Azerbaijan this increase can be explained principally by "the low 2008 benchmark effect": against the background of extraordinarily high energy prices in the first half of 2008 and the small share of energy in the country's intraregional exports, the share of CIS markets in Azerbaijan's total exports appeared to have dramatically reduced. In Kyrgyzstan, the increase in the CIS exports' share of the export structure was attributable to a decline in this index in 2008 resulting from rising gold prices; increasing exports of gold to remote markets in the third and fourth quarters of 2008; and the somewhat better dynamics of exports to CIS markets as compared to exports to remote markets in 2009. In Tajikistan, the increase in the CIS exports' share of total exports can be explained primarily by more sustained exports to CIS markets in early 2009 (compared to remote markets). In Uzbekistan, an upward trend CIS exports' share of total exports started at the end of 2007.

However, it is premature to talk about long-term changes to CIS export and import geography. In 2010, most CIS countries witnessed a recovery of trade with both CIS and remote markets. This gradual revival of CIS countries' foreign trade will inevitably change ratios of intraregional exports and imports, which in turn will depend not only on the level of economic activity in the post-Soviet space but also on the pace of recovery of world commodity markets, price dynamics, etc.

The data in our study provide the basis for interpreting trends in future economic cooperation between post-Soviet states.

Our analysis of the impact of the global crisis on CIS countries' foreign trade debunks the theory that economic interdependence between the region's countries is fading away, as are preconditions for regional economic integration. It was through the intraregional trade channel that the crisis had its greatest impact on the region: it played a decisive, significant or moderate role in 10 of the 12 CIS countries (i.e. more than 19% of the decline in total exports was attributable to the decline in intraregional exports). With regard to the dynamics of commodity revenues, the impact via intraregional (secondary) trade was significant or decisive in 11 CIS countries (more than 20% of the decline in total revenues was attributable to the decline in intraregional trade revenues).

Whereas conclusions regarding the degree and nature of the impact of the global crisis on economic cooperation between CIS countries are clear and indisputable, many trends identified indicate that economic interdependence between them might still prove controversial.

Expectedly, countries most extensively involved in trade within the CIS have experienced the greatest impact of the intraregional dimension of the global crisis; this is true of both raw materials suppliers andmanufacturers of high-value-added finished products. Long-standing cooperation in production and a relatively large proportion of mutual trade accounted for processed products was a decisive negative factor in the dramatic collapse of industrial production in the region's largest economies. Belarus and Ukraine, the region's most integrated economies, were the worst affected by the fall of intraregional exports.

For some analysts, this situation illustrates the excessive vulnerability of mutual commodity trade to the crisis. It has prompted some experts to recommend phasing out this kind of interdependence and to question the benefits of further economic integration. For others, the crisis has proved that the region's largest economies are still heavily interrelated and therefore have laid the foundations for successful regional integration and the maximisation of the economic benefits of integration. In this context, the accelerated introduction of the Customs Union between Russia, Belarus and Kazakhstan at the peak of the crisis appears fully justified, although its composition may seem less than ideal from the economic point of view.

The latest phase of economic cooperation between CIS countries is transitional in nature, and the future of their mutual trade and economic relations will depend largely on how they react to current challenges. The lessons learned from the Russian crisis of 1998 allow us to assume that, should the interested parties fail to make necessary efforts to reverse the downward trajectory of mutual trade, this may result in the permanent loss of existing economic ties. The loss of markets in the post-Soviet space will be highly disadvantageous for most of the region's countries, especially during the recovery phase, as their industrial products remain highly competitive in these markets. The post-Soviet space remains the principal outlet for CIS high-value-added industries such as mechanical engineering. According to the CIS Interstate Statistics Committee, for example, in 2008, the Machines and Equipment category accounted for 10.2% of all Russian exports to CIS markets and for 1.6% of exports to remote markets. This situation is also typical of the entire CIS: in 2008 exports of goods in this category to CIS and remote markets accounted for 17.9% and 1.9% respectively in Belarus; for 2.3% and 0% in Azerbaijan; for 8% and 4.4% in Armenia; for 3.1% and 0.2% in Kazakhstan; for 6.6% and 0.6% in Kyrgyzstan; and for 18.1% and 5.3% in Ukraine. It is therefore obvious that phasing out mutual cooperation will have grave effect on the economic development and structure of CIS countries and make overcoming the crisis even more difficult.

The parties involved must take steps to revive mutual trade links which have deteriorated significantly during the crisis. First of all, they must minimise the effects of the fall in demand for industrial products from CIS buyers. This can be achieved by expanding preferential lending, particularly targeted loans from the Eurasian Development Bank. Furthering regional economic integration would also have a positive effect on the development of CIS economies in the recovery phase. To this end, Interstate agreements on the joint development of certain economic sectors would also be effective.

Our analysis shows that in the wake of the crisis the preconditions for expanding mutual trade are still in existence. Importantly, the relatively strong rate of recovery of the Russian economy and, accordingly, capacity of the Russian market provides CIS countries with unique opportunities to increase their share of exports to this market, provided that the necessary economic policies are in place.

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Regional Effects of the Global Economic Crisis in the CIS: Migrants' Remittances *

4

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Aleksandra Yakusheva

The role of international migration in post–Soviet economies

External labour migration has become an important part of foreign trade. It exerts significant influences on recipient and donor economies, primarily through the migrants' remittances channel.

Intensive migration began in post-Soviet countries soon after independence. The 1990s saw a Russian exodus from the former Union republics, which in many cases was caused by social tension or interethnic conflict rather than economic hardship alone. Identifiable trends in true labour migration from CIS countries to Russia emerged in the 2000s.

The main reason for this migration was the considerable disparity in per capita income between individual CIS countries. The visa-free regime between CIS countries, relatively simple border-crossing procedures, ease of finding work, mutual recognition of diplomas and common mentality and language all facilitated this process. The two main recipient countries were Russia and Kazakhstan, which had the highest per capita income in the CIS (see Table 4.1).

	2000	2001	2002	2003	2004	2005	2006	2007
Armenia	593	659	740	874	1113	1523	1982	2853
Azerbaijan	648	693	749	864	1019	1538	2415	3759
Belarus	1043	1242	1474	1810	2318	3098	3805	4672
Georgia	686	728	777	919	1188	1484	1765	2326
Kazakhstan	1229	1490	1655	2063	2863	3786	5261	6638
Kyrgyzstan	278	308	322	381	435	479	546	725
Moldova	354	407	458	547	720	830	949	1229
Russia	1794	2096	2377	2968	4100	5322	6932	9140
Tajikistan	160	167	188	237	309	337	402	520
Turkmenistan	1082	1469	1815	2347	2871	3419	4192	5006
Ukraine	642	788	886	1057	1378	1844	2319	3090
Uzbekistan	551	461	378	393	460	542	636	821

Table 4.1.
Per capita GDP in CIS countries in 2000–2007 (in $ at the current exchange rate)
Source: IMF, 2010

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In 2000, according to the CIS Interstate Statistics Committee, the difference in wage levels between Kazakhstan, which paid the highest wages, and Tajikistan, which had the lowest, was 12-fold. Later, Russia moved into the lead with regard to nominal wages, but there was still an eleven-fold gap between the countries at the top and bottom of the scale. Throughout the pre-crisis period, closest to wages in Russia were wage levels in Kazakhstan, also the destination for large numbers of migrants. Next closest to Russia was Belarus, which is not a significant contributor to or recipient of international migration. The gap between the country's own wages and those of leading countries clearly correlated with the number of citizens-turned-migrant workers in other CIS countries. The largest wage gap in 2008 was between Tajikistan and Russia (Russia's wages were 11 times higher than Tajikistan's); this gap was also considerable in Kyrgyzstan (5 times), Moldova (3 times) and Armenia (2.5 times). These disparities persisted throughout the 2000-2008 period despite the overall growth in wages.

Russia naturally attracts migrants from other post-Soviet countries due to its substantial economy and relatively high per-capita income. According to a World Bank report published in November 2010, Russia is the second largest migrant recipient after the US (WB, 2010), and is the destination point of two of the world's five busiest migration corridors: Ukraine-Russia (which is second only to Mexico-the US) and Kazakhstan-Russia.

Any analysis of international migration is complicated by the difficulty of establishing the actual number of migrants and defining the different types of migration. It has been estimated that Russia presently has 12.3 million officially recorded immigrants (WB, 2010) plus 5 to 8 million illegal immigrants. The latter category includes migrants who remain in Russia after their permitted stay has elapsed.

The influx of labour migrants into Russia continued throughout the pre-crisis period. The number of foreigners in the Russian economy increased 11.4 times in 2000-2008. In comparison, the number of Russians who moved abroad to work in that period increased 1.6 times (Elefterova, 2010).

According to the CIS Interstate Statistics Committee[1], 29% of all immigrants in Russia in 2009 were from Uzbekistan, 16% from Tajikistan, 9% from Ukraine, 7% from Kyrgyzstan and 7% from Moldova. In total, about 75% of registered migrants were from CIS countries. The situation was different in Kazakhstan: only 9% of immigrants were from CIS countries and the rest were from Southeast Asia, mainly Vietnam. Workers from Kyrgyzstan, Tajikistan and Uzbekistan dominate the foreign workforce in the Kazakh economy. In

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[1] *www.cisstat.org*

the pre-crisis period there were 800,000 migrant workers from Kyrgyzstan, 1.5 million from Tajikistan and 2.5 million from Uzbekistan; they constitute 15%, 20% and 9% of their home countries' population respectively.

Generally, migration flows between CIS countries are reversible, i.e., the migrant's family remains in his home country and he sends them most of the money he earns. In some cases, however, families also move and form resident ethnic communities, and such migrants cannot be classified as labour migrants. Typically, migrant workers are men (80-90% of the total) who spend between six months and several years in Russia.

Labour migration helped to ease the tension resulting from severe unemployment in CIS countries. It compensated for the natural decrease in population in Russia and Kazakhstan and filled particular social and economic deficits created by that population decrease. For the first time in the post-Soviet period Russia's population grew by 25,000, and 330,000 people were granted citizenship in 2009 (Noskova, 2009). Immigration thus compensated for the population decrease due to mortality, even though the numbers were not huge. Maintaining a positive balance of migration is now critical for Russia in order to prevent population decline.

According to the Federal Migration Service, in the first half of the 2000s, 20% – 35% of migrants were employed in sales, catering, agriculture or forestry. Around 15-20% of migrants worked in construction and a further 15-20% in transport (Tyuryukanova, 2005). Other sectors employed much smaller numbers of migrants. Some economic roles are now permanently filled by migrant labour, i.e., migrant workers have entirely or almost completely replaced the local workforce because of their competitive advantage (their willingness to accept informal work agreements, the low cost of labour, fewer problems with alcohol, etc.). Migrant-dominated sectors included construction and building repair, utilities, sales and road maintenance. This apparent "reservation" of certain occupations for migrants from particular CIS countries was initially typical only of Moscow, but the trend later spread to other large cities, and other areas.

Most migrants were employed in the shadow economy, which was significant in the early 1990s. Non-regulated migrant flows created the right conditions for various "shadow industries" to emerge. The prominent role of the shadow economy (in employment structures in general and particularly with regard to crossing borders, employment procedures, labour conditions and residence in Russia) makes migration within the post-Soviet space different from other regions due to relative weakness of labour migration authorities, poor information sharing, strong informal structures (ethnic communities and networks) and very low job security for workers. Generally, employers are interested in preserving this situation, since it confers significant competitive advantages such as low labour costs and opportunities to evade social taxes given a migrant workforce, which has little awareness of its rights.

Russia's migration policy is based on the universal principles of overall and national quotas, the pre-emptive right of Russian citizens to employment and the "employer's initiative" (Tyuryukanova, 2005). A migrant becomes a legal worker in Russia when an employer has filed a request with the migration authorities, and a vacant position is available. Quotas create the paradoxical situation whereby large numbers of migrants stay in the country illegally even though there are plenty of officially announced positions available.

In order to ensure that migration flows are of highly qualified rather than unqualified workers, i.e., to improve the professional and social structure of the migrant workforce, the Sootechestvennik ("fellow citizen") programme was launched. Its objective is to repatriate ethnic Russians who have lived in post-Soviet states since the disintegration of the Soviet Union, or who have emigrated to other parts of the world. In this case, entire families will move rather than just the workers, and therefore considerable investment is required in order to provide the necessary infrastructure for returning families. An alternative to labour migration from CIS countries would be the depopulation of Russia's "company towns", but this solution also gives rise to similar problems and need for investment. In any event, the potential number of such migrants is too small, and the impetus for them to move too weak (and continues to weaken) compared with the willingness of labour migrants to move in from other CIS countries, so these alternatives cannot be expected to change the structure of migration flows decisively.

Changes in the distribution of demand for labour have been incorporated into official quotas on certain professions. In 2010, quotas were abolished for certain categories of migrants, primarily for highly qualified specialists ("elite migrants"). The criteria for this category are quite vague (generally, the employer must state that the migrant will be paid at least 2 million roubles a year); it includes top managers, country directors of transnational companies, etc. Quotas were also abolished for engineers, teachers and researchers, but such migrants are very few and typically reside outside Russia.

Migrant quotas were cut by 50% from 3.9 million to 1.95 million in 2009. The decline in demand for labour was a direct result of the crisis and resulting fear of unemployment. (Rossiyskaya gazeta, February 1, 2010). The new quotas were not filled, however, only 82% of the permitted number of migrants was actually allowed into Russia in 2009, and 1.4 million work permits were issued. The number of officially registered migrants fell three times during the crisis from 13.5 million in 2008 to 4.5 million in 2009 (Novyie izvestiya, October 14, 2009). The quotas were reduced unevenly across the regions. The largest cut in quotas (from 600,000 to 200,000 in

2010-2011) was registered in Moscow (employers, advertised 1.4 million vacant positions in 2010) (Interfax, June 3, 2010), but this was principally a political move. The formal explanation was that these vacancies had to be reserved for Muscovites who might lose their jobs during the crisis. In fact, however, the employment specialities of residents and migrants hardly overlap, especially in Moscow. In 2010, the overall Russian quota was reduced by another 40% to 1.398 million[2]. In 2011, this quota will remain almost unchanged (1.235 million), but will be increased by several hundred thousand if Russia's demand for foreign workers turns out to be higher than expected.

However, this data does not accurately reflect the situation. The crisis triggered a massive outflow of migrants from the official sector to the shadow economy. According to different sources, 2 to 3 million migrants lost their jobs between 2008 and the first half of 2010. A decline in demand for labour in Russia and Kazakhstan made things difficult for migrants from CIS countries, but the situation in their home countries was even worse. Despite formal measures to ease unemployment (for example, Tajikistan's government decreed that 180,000 new jobs would be created, which in practice meant several people sharing one job and clandestine redundancies) (Rossiyskaya gazeta, February 1, 2010), there was no reason for labour migrants to return home. On average, only 20% of migrants returned to Central Asian countries. Thus, illegal immigrants in Russia and Kazakhstan accounted for 65-80% of the total number of migrants during the crisis. In order to allow these people to work legally, a licensing system was proposed; migrants employed in the private sector (household assistance, construction, repairs, etc.) are required to buy a licence, which legalises their stay in the country. However, the cost of a licence (1,000 roubles per month) is too high for most migrants and a disincentive for them to legalise their stay.

As a result, although the crisis had a negative impact on migration, it did not change migration trends significantly.

The dynamics of remittances in post–Soviet countries during the crisis

In 2006, before the crisis took hold, Russia was the fifth largest source of migrant workers' remittances ($11.4 billion annually) (Mohapatra, Ratha, 2010) after the US, Saudi Arabia, Switzerland and Germany. Despite a dramatic decline in remittances in 2009, Russia moved to fourth position ($18.6 billion). Russia receives $5.6 billion annually in migrants' remittances from other countries.

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[2] *Data from the website of the Russian Ministry of Health and Social Development (www.minzdravsoc.ru).*

According to the World Bank, global remittances totalled $316 billion in 2009, which represents a 6% decrease compared to the previous year ($307 billion of the total was sent to developing countries). The World Bank forecasts that migrant labour remittances will total $335 billion in late 2010 (remittances made up a total of $325 billion by November 2010), which is nearly the same as in 2008 (Ratha, Sirkeci, 2010). A 7.1% increase in global remittances is forecast in 2011. It should be remembered, however, that this growth is from a low starting point. Even if these growth rates are sustained, they should not be expected to reach pre-crisis levels any time soon.

Globally, the dynamics of remittances during the crisis resembled that of other financial flows, but were somewhat more stable. According to World Bank experts, this is due to the huge number of migrant workers and the fact that migrants send their families only a small part of their income and continue to do so even when their earnings fall (Mohapatra, Ratha, 2010). It is thought that during a crisis or natural disaster, migrants strive to send their families as much as they can. However, the latter statement does not accurately describe the situation in the CIS region. The extremely low living standards of migrant workers in Russia and Kazakhstan allowed them to subsist on negligible sums and send nearly all their earnings to their home countries.

The dynamics of remittances largely correlated with fluctuations in the Russian economy, and permeable borders enabled the effects of the crisis to spread swiftly through the migrants' remittances channel. But the converse is also true: economic recovery in Russia resulted in an increase in remittances, although this growth lagged behind the growth in industrial production.

Remittances from Russia to other post-Soviet countries are also unique in their sensitivity to fluctuations in world energy prices. It may seem obvious in view of the large proportion of oil and gas in Russia's export structure, but this correlation is much weaker in the Gulf states where migrants play an even greater role in the economy. One possible explanation is fluctuations in the exchange rate in the pre-crisis period (Golovnin, Ushkalova, 2011). The collapse of world energy prices coincided with a significant devaluation of CIS countries' currencies. The impact of the rouble exchange rate on remittances manifested itself in a decline in dollar-denominated remittances which was more dramatic than had been anticipated.

Remittances quickly react to the worsening crisis in labour-recipient economies, and any decline in remittances in turn impacts strongly on labour-donating economies. Donor economies are highly exposed to external shocks, and remittances from abroad function as a stabilising buffer against these. The economic contribution of these remittances was remarkable before the crisis. In 2007, for example, remittances accounted for 48% of

GDP in Tajikistan, 29% in Moldova and 27% in Kyrgyzstan[3]. These three countries were included in the World Bank's list of most remittance-dependent countries, based on a threshold of 25% of GDP. Armenia and Uzbekistan are also highly dependent on remittances. Although Uzbekistan does not supply any official statistics in this area, there are grounds for estimating its dependence at 13% of GDP (International Crisis Group, 2010). These statistics go hand in hand with the fact that the Russian and Kazakh economies are highly dependent on migrant workers from CIS countries who dominate certain sectors such as construction.

Migrants' remittances have the potential to stimulate individual sectors of national economies and boost investment and production. On the other hand, this money can also trigger inflation. The mutual interdependence between labour donating and recipient economies manifests itself in the instant spread of negative and positive movement; even before the crisis, the increase in remittances to Central Asian countries helped to fuel inflation as people's increasing buying power led to higher prices. Domestically produced goods were replaced by cheaper Russian and Chinese products, shown by the dramatic increase in import figures in the pre-crisis period.

Before the crisis, the annual growth in remittances in the post-Soviet space averaged 25-35% (Kommersant-Dengi, April 13, 2009). Owing to a lack of data, however, no definitive quantitative assessment can be made. The *Current Transfers* item of the CIS countries' balance of payments can be said to present reasonably accurate picture of remittance dynamics.

At the peak of the first wave of the crisis in late 2008, remittances stopped increasing and in some countries, e.g. Tajikistan, incoming remittances started to decline (Vinokurov, 2009). In 2009, remittances fell throughout the CIS by about 25%, according to the World Bank, and were at their lowest in the second quarter of that year.

Interestingly, the decline in production in the formal sector of the Russian economy was stemmed in the autumn of 2009, but the disproportionate decline in remittances from this country continued. In the first three quarters of 2010 remittances increased, particularly those of migrant workers, but they still fall short of absolute pre-crisis figures. The crisis strained many existing links between post-Soviet countries, as is illustrated by the fact that payments from Russia to CIS countries recover at a slower rate (a lag of 5-10 percentage points) than payments to remote countries.

At the end of 2010 total remittances began to approach pre-crisis levels, but these pre-crisis figures are yet to be achieved (see Table 4.2).

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[3] According to the balance of payments figures presented by respective national statistics committees and the CIS Interstate Statistics Committee.

	2008				2009				2010		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Paid											
Russia	150	135	121	89	82	68	77	94	111	128	118
Migrant workers' remittances	135	129	105	74	70	70	83	103	113	110	111
Russia, paid to CIS countries	142	135	113	81	78	71	78	95	97	108	112
Migrant workers' remittances to CIS countries	138	133	106	74	69	70	80	98	104	103	108
Kazakhstan	86	53	63	77	73	104	78	85	79	81	153
Migrant workers' remittances	82	52	62	76	74	102	79	88	80	83	134
Received											
Armenia	126	123	134	105	77	67	67	79	119	78	-
Moldova	152	157	143	104	69	76	68	91	105	99	153
Migrant workers' remittances	135	136	132	100	58	57	57	72	104	109	134
Moldova, received from Russia	291	201	173	105	89	89	74	101	115	107	143
Migrant workers' remittances from Russia	181	170	192	118	119	71	68	86	113	139	134
Tajikistan	164	184	162	113	75	62	64	79	115	–	–
Ukraine	107	114	107	79	89	75	74	97	99	114	193
Migrant workers' remittances	109	106	94	73	82	70	70	88	80	101	196

Table 4.2. Rate of growth (decline) in remittances (as % of the same period of the previous year)

Source: balance of payments of Russia, Kazakhstan, Armenia, Moldova and Tajikistan (based on respective central bank data)

The dynamics of labour migrants' remittances in individual CIS countries

The Kazakh economy became an early victim of the crisis because it is highly integrated into the global financial system. A rapid decline in remittances from Kazakhstan began in early 2008. In mid-2009 this decline slowed down, but in the third quarter of that year remittances were again 22% down compared to the same period of the previous year, and since then the negative trend has resumed. Until the second quarter of 2010, remittances were declining by 20% per quarter on average. A breakthrough came in the third quarter of 2010, when remittances shot up by 50%. A similar, albeit less dramatic pattern was observed in remittances made by Kazakh migrant workers, most of whom work in Kyrgyzstan and Uzbekistan.

The dynamics of remittances received by Moldova, Tajikistan and Armenia were fairly similar: rapid growth until the end of 2008, a decline in 2009 with the lowest point in the 2nd-3rd quarters, and an upward trend after the third quarter of 2010. There is a direct correlation between the changes in remittances paid from Russia and the remittances received by the three countries mentioned above. Kyrgyzstan, an economy that is strongly oriented towards Kazakhstan, also suffered a 20% decline in remittances at the end of 2009[4]. All these states belong to the group of CIS economies discussed above, which were the most dependent on migrants' remittances in the pre-crisis period.

We are able to study remittances by migrants working in Russia in more detail by using data from various express payment companies (Pochta Rossii, Western Union, Contact, Migom, Unistream, and others). Although these data sources do not include cash carried by migrants themselves and various informal or semi-formal methods of transfer, it enables us to analyse the regional structure of remittances.

The current leaders in terms of remittances received through payment systems are Uzbekistan (25% of total remittances, or just over $2 billion in the first three quarters of 2010), Tajikistan (19% or $1.58 billion) and Ukraine (13% or $1.27 billion). These three countries have been the recipients of the largest sums since the pre-crisis period, but then Ukraine's share increased to 25%.

The average quarterly growth of remittances made through payment systems in the CIS before the crisis was sometimes as much as 70%. The highest growth rates were recorded in remittances to Ukraine and Uzbekistan; these countries were also in the lead in absolute terms. Remittances by migrants from Moldova were also increasing rapidly. As a rule, payments to workers (and, accordingly, remittances) peaked during the 3rd and 4th quarters of each year, and the lowest total payments were recorded in the first quarter (i.e. when most construction work is suspended until spring). These trends are clear in data from previous years. Therefore, the sharp decline in remittances to all CIS countries in the first quarter of 2009 was attributable both to the seasonal factor and to recession. This decline was unprecedented: even taking into account salary cuts in the first quarter, remittances to CIS countries totaled less than 70% of the same period of the previous year.

The different speeds at which remittances fell in response to the crisis can be explained by the employment specialisation of the migrants themselves. Migrants from Moldova who work mainly in construction were the first to be affected by recession in Russia and reduced their remittances in early 2009 (this was reflected in Moldova's balance of payments). By autumn of 2009, decreases in migrants' remittances from Russia were recorded in Ukraine, Armenia and Azerbaijan. The most dramatic decrease in remittances through payment systems was recorded in Ukraine: in the third quarter of 2009, the remittances totaled only one-third of the previous year's figure, but the situation stabilised somewhat in the fourth quarter. Tajikistan's dynamics was better in comparison with other economies that are heavily dependent

[4] *Balance of payments data of the National Bank of Kyrgyzstan.*

Table 4.3. Remittances from Russia made through the main payment systems (in % of the same period of the previous year)

Source: Central Bank of Russia.

The payment systems include: Anelik, BLIZKO, Coinstar Money Transfer, Contact, InterExpress, Migom, MoneyGram, PrivatMoney, UNIStream, Western Union, AsiaExpress, Allyur, Blits, Bystraya Pochta, Zolotaya Korona, Lider, Pochta Rossii

Note: 1 – transaction amount; 2 – average transaction amount.

	2008								2009								2010					
	Q1		Q2		Q3		Q4		Q1		Q2		Q3		Q4		Q1		Q2		Q3	
	1	2	1	2	1	2	1	2	1	2	1	2	1	2	1	2	1	2	1	2	1	2
Total	170	117	167	123	155	117	111	99	69	74	69	70	68	70	86	80	129	103	128	101	130	102
Remote countries	144	112	153	117	125	104	100	98	65	78	69	76	88	85	155	67	217	80	211	79	191	78
CIS countries	174	119	168	124	158	118	112	100	69	75	69	70	66	69	80	78	119	100	120	99	125	101
Azerbaijan	169	68	167	96	155	86	106	69	68	126	52	120	53	113	68	142	108	106	123	95	117	97
Armenia	149	123	147	125	141	121	109	102	75	42	65	68	65	67	75	72	99	169	112	96	122	99
Belarus	150	125	156	133	156	129	113	108	86	86	92	87	89	82	112	97	156	126	139	109	192	159
Georgia	139	118	133	122	118	124	109	111	70	83	70	77	77	74	-	-	-	-	-	-	-	-
Kazakhstan	157	131	181	147	160	133	115	104	75	81	73	75	86	87	107	104	167	142	150	134	156	134
Kyrgyzstan	171	190	145	116	148	120	111	107	70	55	107	48	97	46	110	43	167	82	120	100	120	97
Moldova	175	117	182	157	155	154	121	134	55	112	67	71	63	72	77	80	125	66	105	98	116	103
Tajikistan	166	87	141	133	128	126	92	96	69	72	88	66	114	67	118	89	141	106	131	94	132	95
Turkmenistan	160	123	200	137	188	131	120	115	75	93	67	84	67	82	83	88	117	105	100	98	100	102
Uzbekistan	216	105	181	116	166	108	112	93	71	72	79	86	76	85	95	95	140	127	134	99	142	104
Ukraine	185	180	212	123	195	119	127	102	71	80	45	58	33	56	58	62	111	79	140	113	135	111

on remittances: after a decline in the first quarter of 2009, pre-crisis levels were restored in the middle of the year. This can be explained by the fact that Tajik migrant workers were very numerous and many of them were employed in utilities and sales (i.e. sectors which were least affected by the crisis) or had poorly paid jobs, which locals were unwilling to take. Remittances from Russia to Belarus also remained stable, but these were made mainly by citizens rather than migrant workers. Most CIS countries (especially in Central Asia) saw a noticeable increase in remittances in the first three quarters of 2010, but this growth should be viewed as a "catch-up" after the preceding decline.

Another indicator of the impact of the crisis on migrant workers is the change in average transaction amounts. Salary cuts resulted in a decrease in the average transaction amount from $800 in early 2008 to $450 in the first quarter of 2009. By the third quarter of 2010 the figure had increased to $530. At the peak of the crisis the average transaction amount dropped most significantly in remittances to Kyrgyzstan, Armenia and Ukraine. That is, workers from these countries were most affected by the decline in demand for labour in Russia. The volatility of this indicator (there were fluctuations throughout 2009 and the first half of 2010) suggests that the negative consequences of the crisis are still being played out.

Before the crisis migrants' remittances stimulated consumer demand and, to some extent, investment in recipient countries, and the crisis reversed this trend. Retail turnover was stagnant in Armenia and Kyrgyzstan in 2009, and dropped by 5% in Moldova and by 17% in Ukraine. Significant increases in demand were observed in Tajikistan and Uzbekistan only, where retail turnover increased by 13% and 17% respectively[5]. Armenia saw a 50% decrease in construction (Sberbank's Centre for Macroeconomic Studies, 2010), which had previously been financed mainly by migrants' remittances. Despite generally favourable macroeconomic dynamics in Uzbekistan, EBRD experts observed the negative impact of the decline in remittances from Russia and Kazakhstan on the country's economy (EBRD, 2010).

The ratio of migrants' remittances to recipient countries' GDP also declined during the crisis (see Table 4.4). In the first half of 2009, i.e., during the most

Table 4.4.
Ratio of remittances received to GDP (in %)

	2007	2008	2009
Armenia	11.1	10.6	10.5
Kyrgyzstan	26.8	28.8	26.4
Moldova	29.5	28.9	24.5
Tajikistan	48.3	52.7	37.4
Ukraine	2.9	2.3	2.9

Source: Calculated based on data from the central banks of Armenia, Kyrgyzstan, Moldova, Tajikistan and Ukraine and the IMF

[5] *Data from the CIS Interstate Statistics Committee.*

acute phase of the crisis, remittances to Moldova accounted for 19.5% of the country's GDP (compared to 29% in 2007), and by the end of the year they accounted for 24%. In Tajikistan this index declined during the two crisis years (2008-2009) from 48% to 37%. In other words, remittances in US dollars were declining faster than GDP. This index showed smoother dynamics in Armenia, Kyrgyzstan and Ukraine.

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Migrants' remittances act as a major channel of secondary spread of the crisis in the post-Soviet space. This channel was especially significant for traditional labour-donating countries. Production declined dramatically in Russia and Kazakhstan, as these countries were directly affected by the crisis through the foreign trade channel and were highly integrated into the global financial system. The crisis led to mass staff and salary cuts and delays in payment, which in turn triggered an outflow of migrant workers. Severe unemployment in CIS countries was attributable to two factors: staff cuts, which were directly caused by the crisis and subsequent decline in demand, and the return of migrant workers from abroad. This situation, coupled with the deteriorating living standards of migrants' families, has the potential to increase social tension.

Migrants' remittances turned out to be highly sensitive to the decline in production in Russia and were a significant factor in negative economic developments in the recipient countries. The importance of these remittances for individual CIS countries enables us to conclude that the regional component of the crisis has played a decisive role in these countries, especially in Tajikistan and Moldova.

Despite the recovery in production in Russia's legitimate economy, remittances by labour migrants remain at a relatively low level. This can be explained by the difficulties migrants face getting back the jobs they had before the crisis. In addition, crisis salary levels persist. Thus, this channel of interaction between states appears to be less fluid than, for example, the foreign trade channel: positive post-crisis developments are channelled through it indirectly and with a long time lag.

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5 Spaghetti, Noodles, and Lapsha in Eurasia: Results of Gravity Regression for the Eurasian Supercontinent

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Abstract

This paper makes an attempt to assess intraregional trade in the Eurasian supercontinent during the post-Soviet period. Applying a gravity regression for a period between 1995 and 2008, we assess the dynamics of trade agreements in Eurasia, often nicknamed 'spaghetti' in Europe, 'noodle' in Asia and 'lapsha' in the post-Soviet region. Finally, we perform a simulation of trade potential and evaluate to what extent Eurasia and all its groupings over-trade or under-trade with each other. Despite the recent regionalism activities in this supercontinent we found a lot of potential, but less evidence of integration.

Introduction

Eurasia is a massive and diverse supercontinent that stretches for 8232 km from Cape Dezhnev in the East to Cabo da Roca in the West and 8505 km from Cape Chelyuskin in the North to Cape Piai in the South. For many centuries it was home to the Great Silk Road that brought goods and prosperity from Europe to Asia. Linking China and the Roman Empire through Russia and the Central Asian region, there were three important trade routes between the East and the West. The goods were passed from stage to stage, requiring sophisticated trade arrangements and financial transactions. Of course, profits from the trade had to be large enough in order to sustain such arduous long distance trade. Political stability throughout the routes also ensured the steady supply of goods and safe passage. Despite the hardships of the distance and geography, the Silk Road was one of many examples in the world that the gravity of nature can be eventually overcome by profit motivations and human ingenuity in trade and finance.

After the dissolution of the Soviet Union the obvious question was whether the emergence of a new trade block would bring trade diversion or trade creation in the Eurasian supercontinent. Applying a gravity model on a sample set of 162 countries, we assess the recent dynamics of intraregional trade in the Eurasian supercontinent during the post-Soviet period. We perform a simulation of potential trade in order to figure to what extent Eurasia and all its groupings over-trade or under-trade with each other compared to regional trade agreements (RTA) in other regions. The title of the paper stems from this focus: spaghetti stands for Europe, noodles for Asia, and *lapsha* (the Russian word for noodles) for emerging trade agreements in the post-Soviet space.

The paper proceeds as follows. Section II provides a brief literature survey, while section III discusses the comparative advantage of the regions and their changing trade patterns. Section IV applies a gravity model to quantify the effects of regional trade agreements, Section V estimates trade potentials and, finally, Section VI concludes the paper.

Europe and Asia = EURASIA?

World economic history, as it was written in the 19th century, identified Europe as the centre of economic gravity. However, up until the end of the 18th century at least half of the world's GDP had been produced in Asia. According to Braudel (1992), in 1750 the global GDP was about $155 billion, 77% of which was generated in Asia. During the 18th century, Europe began to outpace Asia in technological, economical and militaristic development, but by the end of World War II this hegemony had disappeared and shifted back to Asia. Postwar Japan showed high capacity to import and adapt advanced technologies from the USA. Following Japan's example, other Asian countries put their efforts into building an Asian export-driven model of economic development through the so-called 'flying geese' patterns[1]. Blessed with abundant and cheap labour force, Korea, Taiwan, Singapore and Hong Kong quickly promoted industrialisation, initially by becoming subcontractors of Japanese manufacturing companies. Other countries of the region later joined them in the same mode of production.

Up until the collapse of the Soviet Union, Asia and Europe were two quite separate regions. With enlargement of the European Union (EU), and especially rapid economic growth in China and the recent economic rebound in Russia, Eurasia saw a huge growth in intraregional trade between its two biggest regions. Trade between the EU and Asia reached $1.09 trillion in 2008. In 2009, China was the world's largest exporter ($1.47 trillion) and the second largest importer ($934 billion) in monetary terms. The land route between East Asia and the EU can be a potential trade corridor that represents a

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[1] 'Flying geese' pattern is a model for international division of labour in East Asia based on dynamic comparative advantage (Akamatsu, 1962).

great opportunity for smaller and landlocked countries to enter into a stage of potentially strong economic growth as the trade patterns between the regions are largely complementary.

At the same time, Eurasia is home to dozens of bilateral and multilateral trade agreements. However, in most cases they are not in operation. This paper attempts to assess the relative impact of the main multilateral trade agreements in Eurasia: the EU in Europe, Association of Southeast Asian Nations (ASEAN) and South Asian Association of Regional Cooperation (SAARC) in Asia, and Commonwealth of Independent States (CIS) in the post-Soviet space. In addition, we look at the World Trade Organisation (WTO) and groupings in North and South America and Africa to control for other effects since we use global dataset.

An issue of regionalism versus multilateralism has been a topic of long discussions since Viner's model of a customs union (Viner, 1950). Much of these discussions address trade creation and trade diversion effects of an RTA. Bhagwati and Panagariya (1996) and Panagariya (1999) favour multilateralism by arguing that smaller countries lose from an RTA and gain from multilateral agreements. Since RTAs give preferential treatment to member countries, they divert trade from non-members. The liberalising country foregoes tariff revenue from the new union members. From this point it follows that the larger the trade partner's share of total imports, the bigger the tariff revenue loss when a trade agreement is formed. Since developing countries often have high trade dependencies and high tariffs, Bhagwati and Panagariya argue that they will lose from an RTA. They make the case for multilateralism, arguing that the smaller country gains when domestic producers compete at the world price, and any tariff revenue transferred to the RTA partner will be returned to domestic consumers.

De Melo et al. (1993) present a more balanced view of the welfare effects of an RTA by considering an analytical model in which integration can both create and divert trade. In this setting: (i) the higher the pre-RTA tariff and the lower the post-RTA tariff, the larger the benefits and the smaller the costs of adopted RTA; (ii) the larger the production cost differences within RTA members, the less likely that the cheap goods will be sold outside an RTA; and (iii) the greater the complementarity in import demands between the union partner, the greater the gains from an RTA. The latter is related to the 'natural trading partner' theory that suggests regional trade agreements reach their full potential when the political and ideological differences among participating countries are minimal.

Another point of view is the so-called 'spaghetti and noodle bowl' approach first introduced by Jagdish Bhagwatti (1995), which suggests that different tariffs and rules of origin in multiple RTAs result in a spaghetti/noodle bowl phenomenon that increases the burden for business. Bhagwati focuses on the fact that the rules of origin are operative under RTAs because of the selective nature of these agreements: to reduce or eliminate tariffs only on specific items imported from specific countries. This proposition is almost meaningless under a multilateral agreement, like the WTO, because equal tariff rates are applied to all imports, regardless of their country of origin, as long as the country is a WTO member. Based on this, Bhagwati argues that the creation of numerous regional agreements makes production network among countries inconsistent from economic efficiency point of view. He called this situation a spaghetti bowl phenomenon.

On the other hand, with the slowdown in progress of Doha trade deals, comprehensive well-designed RTAs may be a means of achieving regional liberalisation and structural reforms, which could constitute a building block to multilateral liberalisation. The 'noodle bowl' phenomenon caused a recent boom of RTAs in Asia and created specific costs and benefits for the region, as well as for the world economy. It suggests that, in the absence of a Doha trade deal, comprehensive, well-designed RTAs may be a means to achieve regional liberalisation and structural reforms, which can constitute a building block to multilateral liberalisation. Countries reap benefits from an RTA when they create and enhance long-term market access opportunities for their products and services. For many export-oriented economies, such as the ones in Asia, the access to foreign export markets was crucial. Although a country must open its domestic market to its RTA partners, the liberalisation process enables the country to source cheaper imports from its partners, which it can use as inputs to its export production. In addition, the goods, services and investment sectors of all RTA members are forced to improve their efficiency to hold their own against competition both inside and outside the RTA. Cheaper imports will also benefit consumers. That brings overall benefits from spaghetti regionalism.

The recent trade is that more and more countries are turning their attention to RTAs. Countries are taking that route because these agreements are often a more practical and feasible way to liberalise trade. RTAs can bring faster results than the multilateral process. They may enable the parties to make commitments that are more meaningful and more trade liberalising than a multilateral grouping. And very often they address issues that are not even on the multilateral agenda. RTAs can be valuable in dealing with tough issues, which often cause deadlocks on the multilateral front in areas such as agricultural services.

The slow pace of multilateral negotiations has given a greater impetus to bilateral and regional trade negotiations. According to a recent count by the WTO, there are almost 300 regional or bilateral free trade agreements in force. And this number is expected to rise in coming years. Eurasia is a home to a dozen regional trade agreements, and together they comprise a noodle

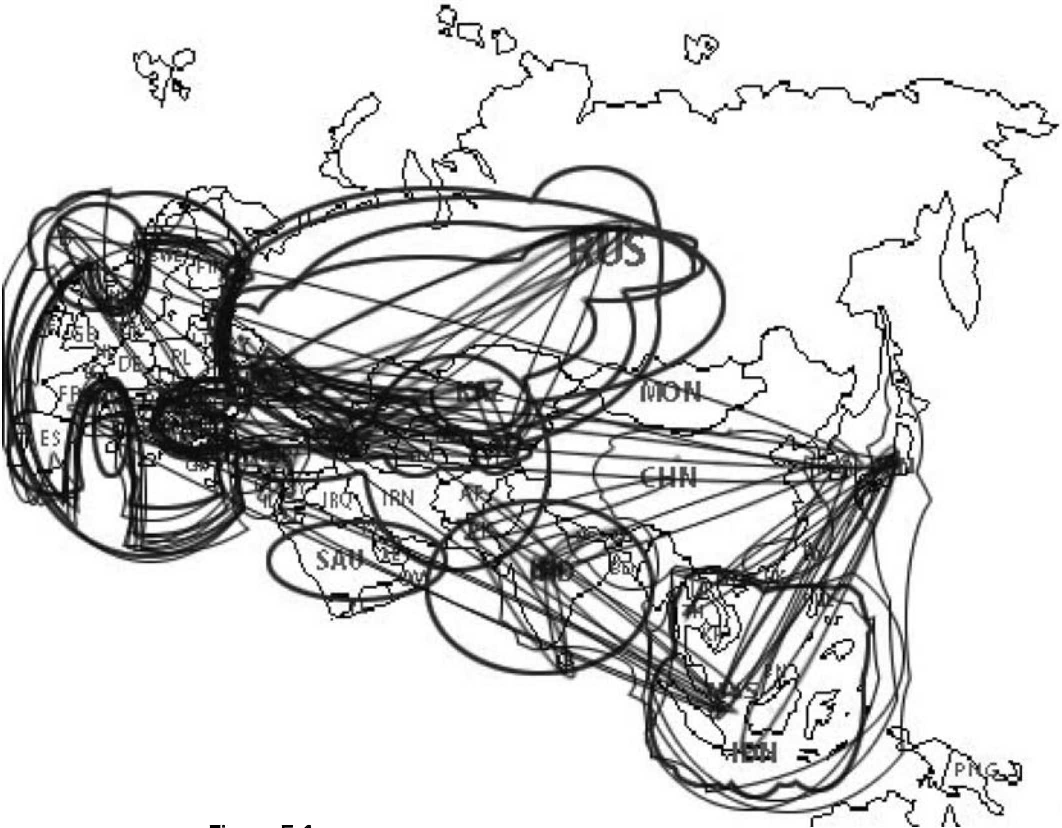

Figure 5.1.
Eurasian Spaghetti-Noodle-Lapsha

bowl in Asia, a spaghetti in Europe and a lapsha in between two regions (see Figure 5.1). The EU has been active in this area for years. Asian countries such as Japan, Korea and China are actively negotiating agreements with their neighbours and more distant trading partners.

The very success of these negotiations can make liberalisation on a multilateral scale more difficult as governments devote greater time and attention to deals that can be concluded quickly. They can also detract from multilateral efforts by stretching already scarce negotiating resources, especially in developing countries. Whether the end result will be competitive discrimination or competitive liberalisation depends on each particular case. We look at Eurasian agreements to see whether wider markets helm economic agents to achieve economies of scale in production, and thus, lower the average cost of output per unit. We use the spaghetti, noodle and lapsha of Eurasia and try to make a single recipe.

Trade Patterns and Structure

From the beginning of a century Eurasia has seen a huge growth in its international trade. The figure below shows intraregional trade dynamics in the Eurasian supercontinent. Eurasia, together with the rest of the world, has seen a dynamic growth in trade since the 1970s. However, the speed was different. In general, the world trade in the 1960s was 30% less open than today's trade (see Figure 5.2). Continental Europe has been in a leading position since the creation of the European Economic Community (EEC) in 1958 with an average tariff rate of 18% (Baldwin, 2006). By 2000 when all the cuts in the Uruguay round were phased in, the average tariff rate reached 4% and the trade openness of Europe reached 80%. The speedy economic reforms in China and dissolution of the USSR played a major role in a drastic increase in trade in Europe and Central Asia and, in turn, the emergence of the spaghetti bowl in the region.

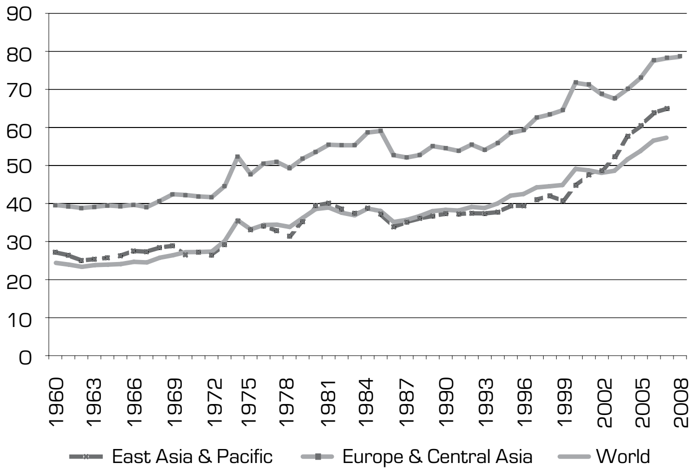

Figure 5.2. Dynamics of Eurasian Trade Openness $\left[\frac{\text{Exports+Imports}}{\text{GDP}}\times 100\right]$

Source: WDI, World Bank

The second part of the past century has also seen a sharp emergence of Asia in trade. Japan's trade grew to over 5% of the world's total and was followed by the emergence of China and a rapid growth of intra-Asian trade. Today Asia counts for 28% of the world's total trade turnover.

Despite this high growth, the share of intraregional trade is still very low for particular groupings (see Figure 5.3). Due to its size and diversity, Eurasia trades a lot within its own continent. The main contributor is the European Union as Asia's groupings and the CIS are still at very low shares of intraregional trade.

If we look separately at Asia, most of the trades are done within the region, less so with Eurasia, with North America being a major trading partner. The post-Soviet region trades less within itself, but more with Eurasia.

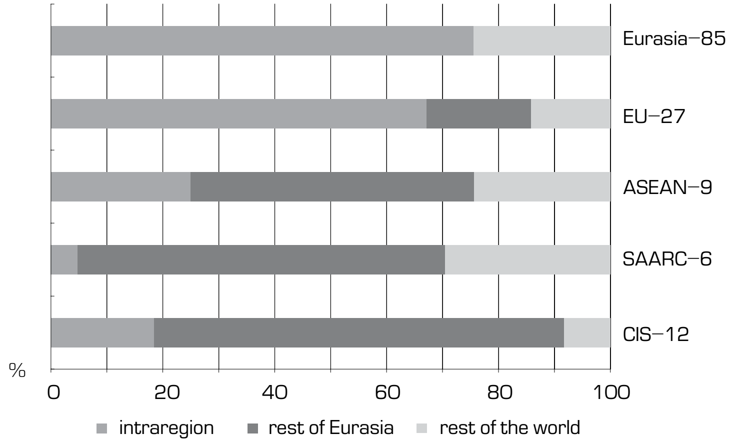

Figure 5.3. Intraregional Trade in Eurasia: 2008

Source: DOTS, IMF

Let's now look at the structure of trade. The structure of intra-Eurasian trade is quite diverse and balanced with each commodity group constituting at least 5% of the total. Although the highest share is held by machinery and electrical equipment (28%), followed by chemicals (13%) and mineral products (13%), the main contributor of high-skilled manufacturing trade is still the EU (its old and new members), while textile and electrical goods are usually supplied by Chinese producers.

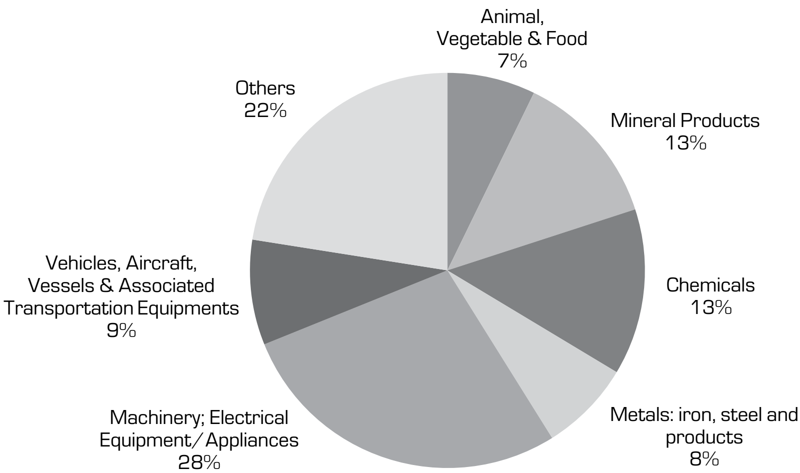

Figure 5.4. Structure of intraregional trade of Eurasia: 2009

Source: TradeMap, WTC

The emergence of Eastern Europe and former Soviet states provided a space for commodity diversification of production structure within Europe. Asian production and distribution networks have been constantly evolving since the 1960s because of shifting comparative advantages due to improvements in labour force skills, increased capacity to adapt new technologies and the presence of cheap unskilled labour (Foxley, 2010). Russia and Central Asia have a high concentration of raw materials, both intraregional and inside Eurasia.

Gravity Regression

The gravity model has its roots in Newton's gravity law, which says that gravitational force between two objects is positively related to relative masses and negatively related to distance between them. The estimated model contains data for 162 countries over the period 1995-2008. Trade data come from IMF DOT Statistics database. Zero-valued trade is omitted, as in this dataset missing trade means an absence of trade (Coe et al, 2002), and estimation is carried out on an unbalanced panel dataset. All variables, excluding dummies are in natural logarithms. Following Baldwin and Taglioni (2006), we allow for country and year heterogeneity, and use real values of variables (e.g. trade deflated by US CPI, real GDP). Following Carrere (2006) we chose Hausman-Taylor (1981) estimation technique, which allows fixing the omitted variables bias. Following Baldwin and Taglioni (2006) we allow for fixed time and each country's effect. A short description of the gravity model and data estimation techniques is presented in the Appendix. We add a remoteness variable to control for home bias effect.

We start by looking at the interaction of RTA dummies and time dummies to see the evolution of integration processes for main trade groupings in the world between 1996-2008[2]. *Figure 5.5.* shows that the main trade agreements in Eurasia – the EU and the ASEAN demonstrate increasing importance of intraregional ties, while importance of the CIS and the SAARC is growing at a slower pace. Dynamically growing intra-regional ties of EU and ASEAN act as a hub that attracts newcomers to join their agreements. Thus, during 1996-2008 EU-15 attracted Eastern neighbours and has grown to EU-27. Most recently ASEAN concluded trade agreements with Japan, China, Korea and India. Slower development of intraregional trade of CIS and SAARC probably reflects high share of informal trade. For instance, in South Asia informal trade comprises 50-100% of formal trade.

The evolution of the Eurasian dummy is somewhere in-between though it is more dynamic than the WTO dummy. Despite the inclusion of China in 2001, protest activity surrounding the WTO Ministerial Conference of 1999 in the United States slowed the pace of multilateral negotiations.

On the other hand, the regression results indicate that WTO members trade 6-13% above the world average. Unlike them, hub groupings in the

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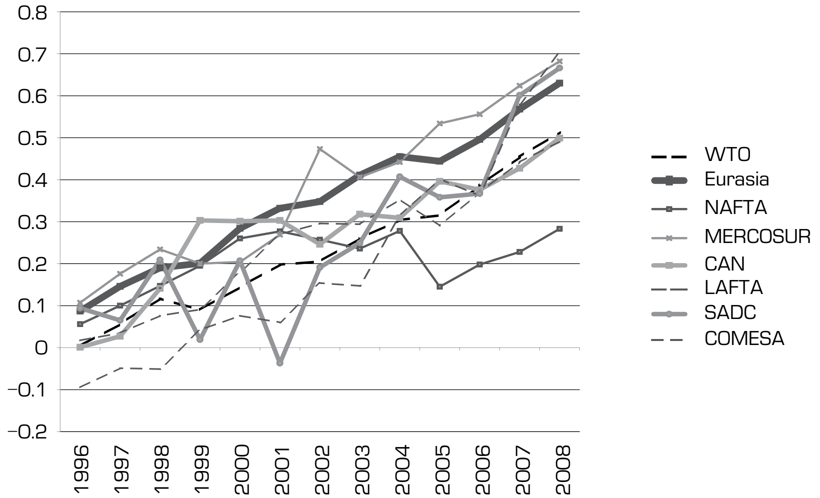
[2] *We follow Brambor et al (2006) in interpreting interaction terms.*



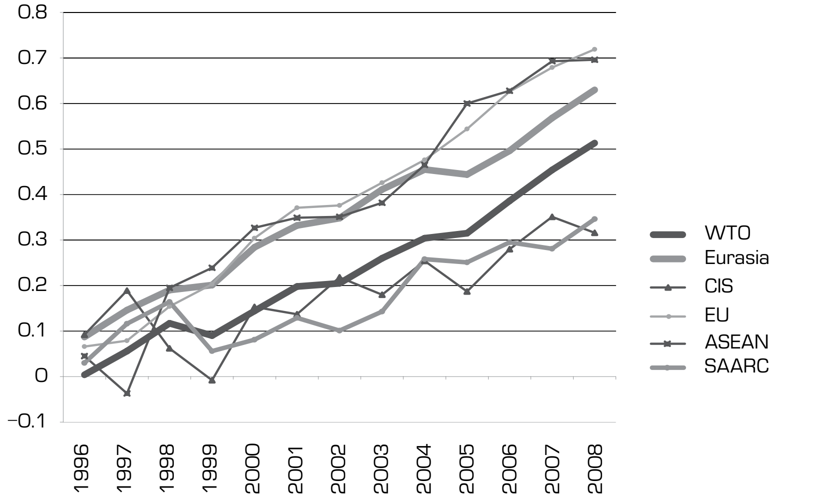


Figure 5.5.
Evolution of regional dummies

Eurasia trade 17-38% below the world average, although the coefficients for both the EU and ASEAN are not significant. Coefficients of CEFTA and CIS present positive and statistically significant signs, while the coefficient for SAARC is not significant. The point estimate of 2.4 for the CIS implies that when two countries of a pair belong to that grouping, they trade 10 times the level [exp(2.4)-1=10] that two other similar countries would trade.

For the non-Eurasian groupings it can be clearly seen that all groupings in North and South America, as well as Africa, except for Common Market for Eastern and Southern Africa (COMESA), trade above average. The only coefficient that is statistically significant is for Latin American agreement. Evolution of MERCOSUR (Southern Cone Common Market) dummy over time has been similar to hub dummies in Eurasia, while African RTAs have been showing strong progress since 2000.

Trade Potentials

An interesting picture arises from our estimates of trade potential. In Eurasia, the CIS grouping over-trade with each other, while ASEAN and the EU under-trade. ASEAN, which is probably the most important trade block in Asia, has trade potential levels somewhat comparable to those of the EU.

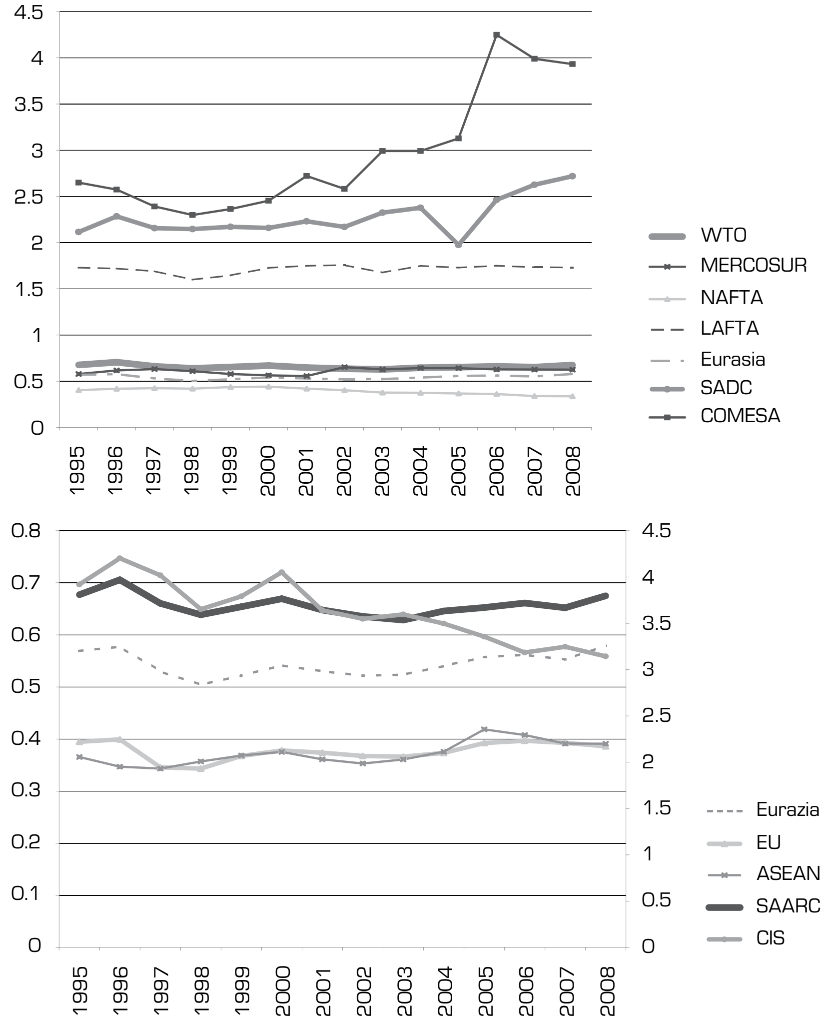


Figure 5.6. Realisation of Trade Potentials: actual trade / potential trade

These dynamics make intra-Eurasian trade still below its potential level but rapidly increasing.

African groupings largely over-trade with each other. This trend has emerged since 2000 and is rapidly increasing. In the Americas the level of over-trade is not very high and somewhat similar to wider-Eurasian potentials, with North American Free Trade Agreement (NAFTA) and MERCOSUR being under the level of trade potential and Latin American Free Trade Association (LAFTA) being above.

Conclusions

There are two explanations of the regional trade spaghetti, noodle and lapsha bowls phenomenon in Eurasia. On one hand it is the consequence of no clear leadership within its two regions: Europe and Asia. In Asia, Japan and China dispute the role, while Korea is promoting trade and culture. More integration with the EU is not visible in the near future due to the fact that the EU economies are currently trying to overcome existing economic problems. On the other hand, the absence of progress with multilateral agenda calls for further regional negotiations. Instead, greater diversification of exports destinations to elsewhere in Eurasia and beyond will probably be an important source of additional growth in the near future.

In general, we have three main findings from this empirical exercise. First, both Eurasia and the WTO are found to be below their potential levels, while Eurasian intracontinental trade is more dynamic and with more room to grow. Second, for two hub-groupings in the region – the EU and the ASEAN – despite disputes and economic slowdown, actual trade is well below its potential level, and we can only expect them to grow further. Third, intraregional trade in the CIS is still above the levels predicted by the gravity model. It is coupled with a continuing reduction in exports to each other, which suggests an evidence of trade diversion.

How the integration processes in Eurasia will evolve is a subject for further analysis and observation. Despite the large number of spaghetti-noodle-lapsha RTAs at the present moment we do not yet see any perspective for pan-Eurasian integration in near future.

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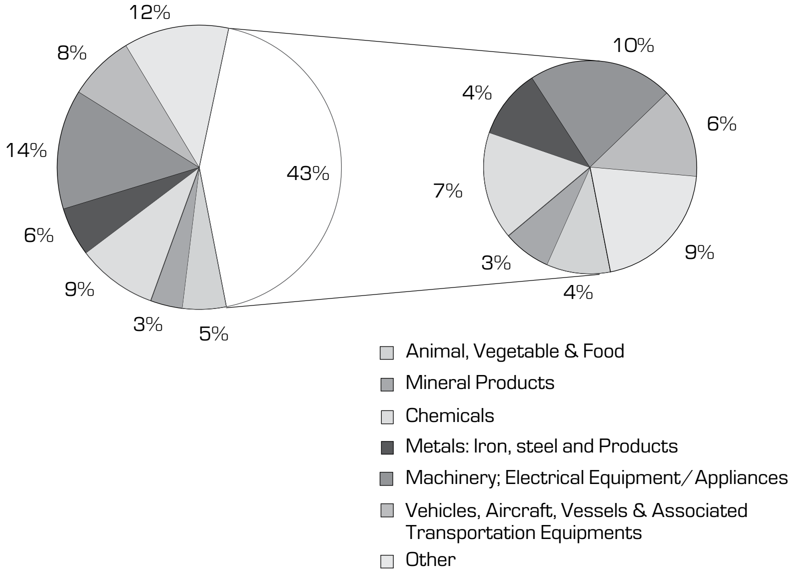
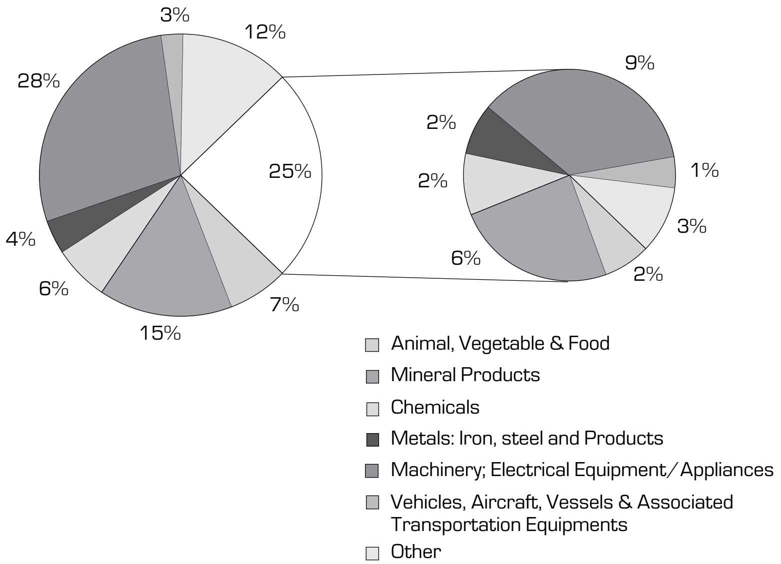
Annex 5.1. Trading structure of regional groups in Eurasia

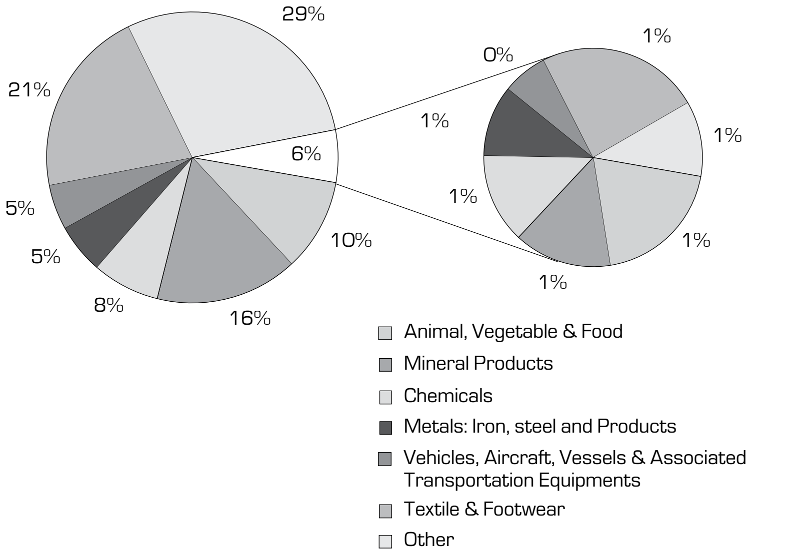
EU–27



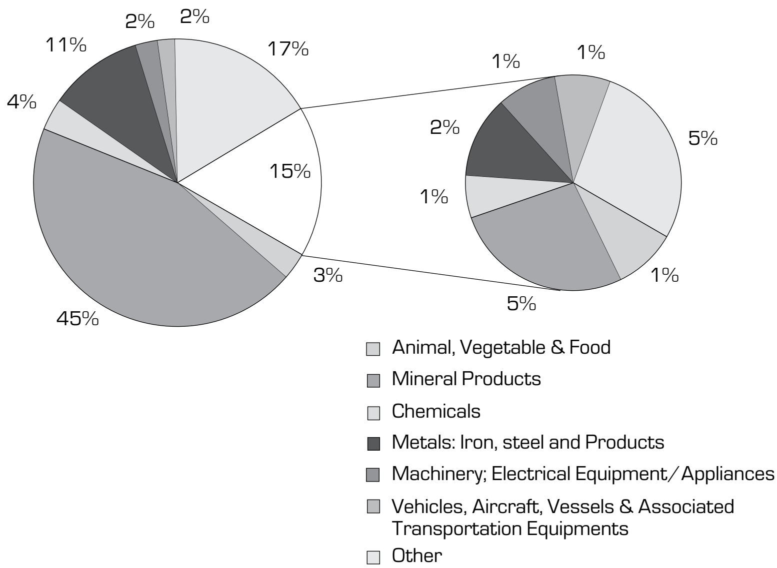
ASEAN



SAARC



CIS



The Basics of the Gravity Model

The gravity model of international trade takes its roots from Newton's gravity equation, and relates the trade between a pair of countries to their economic mass, often measured by their respective GDPs, and the distance between them. It was brought into use for the estimation of international trade by Tinbergen (1962) and Poyhonen (1963). Anderson (1979) and

Bergstrand (1985), Helpman and Krugman (1985) and Evenet and Keller (2002) developed theoretical justifications based on increasing returns to scale, imperfectly competitive markets and firm-level product differentiation. Anderson and van Wincoop (2003) improved the empirical microfoundation of the gravity equation by introducing a theoretical and practical way of deriving a "multilateral resistance" term.

A great volume of empirical literature use gravity equation for the estimation of trade, investments and other bilateral transactions. The most notable estimations of bilateral trade flows are Frankel (1997) and Rose (2000). Egger (2002) suggested a correct way of controlling for heterogeneity in gravity equation on panel data and estimation of trade potentials. Finally, Baldwin and Taglioni (2006) sorted out the empirical specifications and use of dummy variables. We follow their specification as:

$$\frac{V_{ij}}{P_{USA}} = \tau_{ij}^{1-\sigma}\left(\frac{GDP_i}{P_i^{GDP}} \times \frac{GDP_j}{P_j^{GDP}}\right), \text{ where } \tau_{ij} = f(dist_{ij}, \text{otherstuff})$$

Despite the recent suggestions of two-stage non-linear estimations (Helpman et al, 2008) we favour the Hausman-Taylor (Hausman-Taylor, 1981) estimation that became a widely accepted and standard technique for estimation when the gravity model is applied (Egger, 2002 and Carrere, 2006)[3]. The Hausman-Taylor method allows for the inclusion of time-invariant variables in trade projections and circumvents the problem of an ad hoc estimation of the country pair-specific dummy variable needed for a projection based on the fixed-effects estimator. In addition, it removes the correlation between the error term and included variables which often plague random-effects estimation.

Name	Description	Source
Trade	Log of bilateral trade (exports + imports) deflated by US CPI	DOT Statistics, IMF and IFS, IMF
Distance	Log of great circle distance between capital cities	
Income	Log of Product of Real GDPs	WDI, World Bank
Wage difference	Log of Product of GDPs per capita	WDI, World Bank
Remoteness	Log of simple average of remoteness variable	WDI, World Bank and distance
RTA dummy	1 for country pairs that belong to RTA, and 0 otherwise	Wikipedia
Interaction variables	RTA dummy multiplied by variable	

Data Definition and Sources

[3] *Helpman et al (2008) proposes treatment of zero–trade and asymmetric trade flows. But we still think that low trade volumes (no matter if unidirectional or two–way low volumes) signify low development of trade relations. Thus, treatment of multilateral resistance and unobserved effect seem more important to us.*

Results of gravity equation

VARIABLES	Fixed effects	Random effects	Hausman –Taylor
Distance	1.104***	-0.55***	-0.651***
	[0.154]	[0.144]	[0.146]
GDP	0.326***	0.383***	0.383***
	[0.045]	[0.03]	[0.03]
GDP per capita	-0.071	-0.129***	-0.129***
	[0.043]	[0.029]	[0.029]
Remoteness	2.029***	0.363**	0.286*
	[0.156]	[0.145]	[0.147]
WTO	0.112***	0.063***	0.063***
	[0.012]	[0.01]	[0.01]
Remoteness – WTO	-0.02**	0	-0.002
	[0.009]	[0.01]	[0.01]
EU	-0.14***	-0.183	-0.184
	[0.044]	[0.147]	[0.166]
Remoteness – EU	-0.278***	-0.347***	-0.372***
	[0.025]	[0.084]	[0.094]
ASEAN	-0.264	-0.452	-0.458
	[0.17]	[0.573]	[0.648]
Remoteness – ASEAN	-0.054	0.036	0.026
	[0.083]	[0.28]	[0.316]
SAARC	0.663**	0.735	0.616
	[0.294]	[1]	[1.127]
Remoteness – SAARC	-0.523***	-0.531	-0.494
	[0.162]	[0.549]	[0.619]
CEFTA	0.22	0.693	0.921*
	[0.14]	[0.469]	[0.526]
Remoteness – CEFTA	0.229***	0.039	-0.069
	[0.059]	[0.199]	[0.223]
NAFTA	1.238***	1.379	1.422
	[0.313]	[1.066]	[1.201]
Remoteness – NAFTA	-1.226***	-1.36*	-1.415
	[0.232]	[0.787]	[0.884]
LAFTA	0.729***	0.808**	0.811**
	[0.094]	[0.325]	[0.368]
Remoteness – LAFTA	0.041	0.037	-0.001
	[0.069]	[0.238]	[0.269]
COMESA	-0.129*	-0.049	-0.029
	[0.075]	[0.235]	[0.27]

VARIABLES	Fixed effects	Random effects	Hausman –Taylor
Remoteness – COMESA	0.433***	0.342**	0.355**
	[0.045]	[0.145]	[0.166]
MERCOSUR	0.752**	0.609	0.713
	[0.309]	[1.076]	[1.218]
Remoteness – MERCOSUR	-0.451***	-0.42	-0.469
	[0.124]	[0.433]	[0.49]
SADC	-0.13	0.016	0.114
	[0.14]	[0.437]	[0.499]
Remoteness – SADC	0.301***	0.283	0.19
	[0.079]	[0.252]	[0.286]
CIS	2.272***	2.383***	2.429***
	[0.07]	[0.235]	[0.266]
Remoteness – CIS	-0.265***	-0.27*	-0.253
	[0.043]	[0.145]	[0.164]
Constant	-26.568***	-14.018***	-12.799***
	[2.043]	[1.858]	[1.949]
Number of observations	118797	118797	118797
R-squared	0.773	0.909	0.909
Number of pairs		10233	10233
Hausman test		769	167.3

Note: Standard errors in parentheses, statistical significance: *– at 10%; **– at 5%; ***– at 1%

6 Developing the Institutional Structure of the Eurasian Economic Community

Nikolai Kaveshnikov

Introduction

The effectiveness of the Eurasian Economic Community (EurAsEC) is largely determined by the effectiveness of its institutions, their ability to make decisions aggregating the interests of all member states and the ability to enforce those decisions. A strong institutional structure is particularly important during the transition from negative to positive integration, i.e., in the case of the Eurasian Economic Community, the creation of the EurAsEC Customs Union. This in turn means that many of the most crucial decisions are made in real mode (e.g., management of customs policy). In this paper we examine the formation and development of the institutional structure of the Eurasian Economic Community, the interaction between its bodies, decision making mechanisms and process of implementing of the decisions. We analyse the institutional structure of the Eurasian Economic Community in terms of its dependency on objective economic and political processes in the post-Soviet space, and in terms of its impact on the dynamics and direction of the integration process.

The institutional structure of the EurAsEC, and the basic operating parameters of the Customs Union (CU) and Common Economic Space (CES), were all based on the example of the European Union (EU). The leaders of the Community have pointed this out on several occasions. For example, the chairman of the Council of Federation Committee on the CIS Issues, V.A. Gustov (2008: 19) argues: "Without exaggeration we can say that recently developed regulatory and legal frameworks for regional integration [*meaning mostly the EurAsEC* – **N.K.**] in the world are largely a reflection of practice of the establishment and development of the EU". Therefore, this study is built largely on the comparative analysis of EU institutions and the EurAsEC.

However, regional characteristics differ so greatly that even though the EurAsEC's institutional structure is based on the EU experience a fundamentally different organisation is developing. At the outset it is important to mention two key observations. Firstly, a comparative analysis of the institutional structures of the Eurasian Economic Community and the EU does not equate "different" with "bad". The various shortcomings of EurAsEC's institutional structure will be discussed further. However, many differences are caused by objective factors and therefore cannot even be considered as shortcomings.

Integration processes in the former Soviet Union have certain specific characteristics, i.e., the low proportion of intraregional trade; the significant role of extra-regional actors (the EU, China, USA, and, in part, Turkey), whose economic and political influences contribute to the "breaking up" of the integration space; and the absence of significant historical experience of statehood for many countries emerged after the collapse of the USSR, which makes any attempt at limiting national sovereignty extremely problematic.

Secondly, the EurAsEC and the EU have disparate historical experience having been in existence for 10 years and 60 years respectively. Enhancing integration requires solutions that are possible only when there is a high level of mutual trust, which in turn develops only from the experience of cooperation, and any accumulation of experience results from a step-by–step approach over a long period of time. Any attempt to speed up the process is most likely to lead to failure. That is why existing comments on the institutional structure of the EurAsEC are not intended as criticism but as constructive approaches for further development.

The Bodies of the EurAsEC

Before analysing the institutional structure of the EurAsEC, it is important to give a brief description of EurAsEC's principal bodies. Its governing bodies are the Interstate Council, the Integration Committee, the Interparliamentary Assembly and the Community Court. Subsidiary bodies include the Integration Committee Councils, the Commission of Permanent Representatives and the Secretariat.

The EurAsEC Interstate Council is the supreme governing body of the Eurasian Economic Community. The Council is composed of heads of state and heads of government.

The Interstate Council "considers questions of principle in Community activities affecting the common interests of member states, defines the strategy, directions and perspectives for developing integration and takes decisions aimed at implementing EurAsEC goals and objectives." (Treaty, 2000, article 5). This is the only body that can adopt decisions binding for member states. The Interstate Council approves decisions on a consensual basis. In general, this body resembles the European Council apart from the fact that the decisions of the European Council are de jure non-binding.

The EurAsEC Integration Committee is a standing body of the Eurasian Economic Community.

The Integration Committee is composed of the deputy heads of government of the Community states. The main role of the Integration Committee is to support the interaction of EurAsEC bodies, to prepare draft decisions and documents for the Interstate Council and to maintain control over their implementation. The status and composition of the Integration Committee are similar to those of the Council of European Union (Council of Ministers). However, there is a significant difference: the Integration Committee examines and approves draft decisions, prepares proposals, reports and reviews, but it does not decide anything. All decisions are made by the EurAsEC Interstate Council. For that reason, less importance is attached to the Integration Committee' ability to adopt decisions with a two-thirds majority vote.

The Integration Committee may establish subsidiary bodies in the form of councils and commissions, established either to represent a particular policy area or to perform a particular function. Currently there are 18 councils, e.g., the Social Policy Council, the Transport Policy Council, the Council of Heads of Customs Services, etc. In addition, there are four commissions with responsibility for specific aspects of trade policy, e.g., the Commission on Cooperation in the Sphere of Export Control. In general, these bodies are comparable to various configurations of the EU Council of Ministers. However, there is a significant difference in the level of competence and function performed. Sectoral councils are the key decision-making bodies in the EU, while in the EurAsEC they perform two basic functions: preparing draft decisions and implementing agreements between the member states. To say more accurately, the councils themselves do not implement decisions - this is the responsibility of their members, i.e., the heads of public authorities of member states. Thus, the implementation of EurAsEC laws into national legislation (since the law of the EurAsEC has no direct effect) takes place at national level and in the absence of any strict monitoring.

A key subsidiary body of the Community is the EurAsEC Commission of Permanent Representatives. Its role is "to support the ongoing work of the Community, coordinating and reconciling the member states' positions, [...] and supporting the interaction between the Community and the appropriate bodies, institutions and organisations of the Community member states" (Regulations, 2003, article 5). The Commission of Permanent Representatives takes decisions by a two-thirds majority. However, it is specifically stipulated that these decisions are binding only for the Secretariat of the Integration Committee. For the member states, the commissions and councils these decisions are only advisory in nature. The Commission is composed of Permanent Representatives of EurAsEC member states appointed by the heads of member states. The Commission of Permanent Representatives resembles COREPER, which supports the operations of the EU Council of Ministers.

The Integration Committee Secretariat organises the work of the Interstate Council and Integration Committee and provides it with information and technical support. The Secretariat is headed by the Secretary General who is appointed by the EurAsEC Interstate Council for a three-year term of office. Secretariat officials are the highest-ranking administrators of the Community. However, although when on duty they "shall not seek or receive instructions from any party or authority external to the Community" and are responsible only to the Eurasian Economic Community (Regulations, 2001, article 37), their real independence is in doubt. The reason for such doubt is the national quota system for allocating senior posts in the Secretariat. But scepticism about the Secretariat's independence is also expressed because of its small staff. The Secretariat can not be compared with the European Commission: it lacks independence from the member states, has neither legislative nor executive powers and its task is limited to providing support for the Interstate Council and Integration Committee. The only body similar to this in the structure of EU institutions is the General Secretariat of EU Council of Ministers.

There are two further governing bodies whose status is secondary to those mentioned above: the InterParliamentary Assembly and the Community Court of Justice.

The Interparliamentary Assembly of the Eurasian Economic Community (EurAsEC IPA) is the Community's body of parliamentary cooperation. The objectives of the IPA are "to facilitate the formation of a coordinated EurAsEC legal policy; to coordinate the legislative activities of the national parliaments in order to achieve EurAsEC's goals and objectives; and to assist in creating organisational and legal conditions for bringing the national legal codes of Community member states into line with treaties concluded within the framework of EurAsEC" (Regulations, 2002, article 2-3). The IPA plenary session is held once a year, but there are several committees working on a permanent basis. A key feature of the IPA is that it does not participate in preparing Interstate Council decisions and EurAsEC international agreements.

The Community Court of Justice is charged with providing a uniform interpretation of EurAsEC law and settling disputes of an economic nature arising between the Parties on matters relating to implementation of the decisions by EurAsEC bodies and the provisions of treaties adopted within EurAsEC. Decision of the Court is adopted by two-thirds of the judges. Presently the CIS Economic Court of Justice executes the function of the Court of Justice of the Eurasian Economic Community.

Features of the EurAsEC's institutional structure

Our theoretical analysis focuses on a few key features of the institutional structure of the EurAsEC.

1. "Integration processes [*in the EurAsEC* – **N.K.**] develop at various speeds and on different levels" said Russia's Deputy Prime Minister,

S.E. Naryshkin (2008, 15). It could even be said that the idea of differentiated integration in the CIS has reached its ultimate realisation.

There are several types of differentiation:

- opt-outs – when a country stipulates that it exempts itself from certain technical aspects of a policy or indeed exercises its right not to participate at all in a particular policy area (for example, Britain is not part of the Schengen zone);
- opt-ins – when a country, having exercised the right to not participate in some policy area, retains the right to participate in certain aspects of this policy (this would apply to the participation of Great Britain and Ireland in the development of the Area of Freedom, Security and Justice in the EU);
- the vanguard and rearguard model – when some countries of the integration organisation form a group to implement a large-scale project, and the rest of the countries are either unwilling or unable to participate in this. They reserve the right, however, to join the vanguard in the future (e.g., the euro zone in the European Union).

In practice, CIS countries always have the right to choose whether or not to sign each of the international agreements within the CIS framework. Since there are no time limits for the ratification of these agreements, the CIS countries also have the right to ratify or not to ratify such agreements. As a result, by the year 2000, half of the former Soviet republics had ratified between 40-70% of the CIS agreements they had initially signed (Analytical Report, 2001: 75). These ratified agreements are often not enforced in any case, although this is not relevant to the notion of differentiation.

Political leaders were aware of the fact that the absence of a unified legal framework is a hindrance to any integration initiatives. From this perspective, the creation of EurAsEC was a great step forward – the legal framework of the Community exists in the form of the EurAsEC Treaty and other Community agreements determined by the decision of the Interstate Council. Article 9 of the EurAsEC Treaty states that the adoption of all these agreements is mandatory for any country acceding to the Community, i.e., it implies that this is obligatory for all member states. In this respect, the EurAsEC legal framework is completely analogous to the EU acquis[1]. Another extremely important factor that contributes to the unity of the legal framework of the Eurasian Economic Community is the fact that these treaties could not be signed with reservations. Thus, EurAsEC is committed to avoiding the phenomenon of disorderly differentiation, which former

[1] *Although the scope and status of the documents are in no way comparable.*

president of the European Commission Jacques Delors warned against in Europe, claiming that the European Union risked turning into "a giant department store, where everyone would pay only for what he takes from the shelf" (quoted by Shemyatenkov, 2000: 41)

The apparent complexity of implementing the basis of this integration project, i.e., the creation of the Customs Union and Common Economic Space, can be explained in the following way. Participation in the Customs Union involves a significant revision of the entire customs and tariff system, the formulation of a common trade policy and the establishment of new institutions. All these changes require a high degree of coordination and the adoption of decisions that are disadvantageous in the short term. Also, the creation of the Common Economic Space, conceived as the space of four freedoms, is impossible unless legislation in several areas is harmonised more extensively and unless there are efficient institutions to implement such legislation. There must also be sufficient mutual trust between the member states. In such circumstances, it is easy to understand why, during the creation of the EurAsEC Customs Union, member states began to gravitate towards the vanguard and the rearguard model of differentiation, which is already well established in the European Union.

Three EurAsEC countries make up the Customs Union: Russia, Kazakhstan and Belarus. All the key features of vanguard and rearguard integration apparent in the EU are reflected in the Customs Union:

- The unity of the institutional structure of the vanguard and all of EurAsEC[2]
- The objectives of the vanguard correspond to the basic direction of development and objectives of the whole of EurAsEC
- Creating a vanguard does not negatively impact the level of integration across the whole of EurAsEC
- Other countries may join the vanguard when they are ready to take on additional obligations

Using the vanguard and rearguard integration model brings obvious benefits, but it also has major disadvantages. In the case of EurAsEC, the greatest concern is the imbalance between the level of integration achieved across the Community and the potential (if it is reached) for deeper integration between the countries of the vanguard. In the European Union the built-in vanguard (Economic and Monetary Union) is based on a long and stable functioning EU-wide customs union and single internal market. The EurAsEC, in contrast,

[2] *For example, the supreme body of the Customs Union is the Interstate Council, acting in the member states that participate in the Customs Union.*

is still developing a free trade zone and the current regime is based on a number of bilateral agreements, which are not always followed strictly. In these circumstances, the establishment of the Customs Union and, in particular, the Common Economic Space, risks breaking the Community apart.

The second disadvantage is the fate of the rearguard (Kyrgyzstan and Tajikistan). They will have a very difficult task chasing the hopefully rapidly progressing vanguard. Given the significant differences in the level of economic development of the three leading and the two following countries, the temporal differentiation between the vanguard and rearguard may be transformed into a permanent centre-periphery structure. The question is whether the peripheral countries are reconciled to their status or would they begin to reorient themselves towards other non-regional players. However, the position of the rearguard will largely be determined by the degree of success of the Customs Union and its ability to attract the rearguard economies.

2. The process of integration in the EurAsEC does not correspond to the classical scheme of regional economic integration, i.e., free trade area (FTA) – customs union – common market – economic and monetary union. However, apart from the EU, few integration organisations could boast the agreement of theory and practice. In the North American Free Trade Agreement (NAFTA), the free trade zone is complemented by a major liberalisation of capital flows. In the Association of Southeast Asian Nations (ASEAN) the task of creating an FTA was only adopted in 1992, 25 years after the establishment of the organisation. It was achieved relatively recently, in 2002, and only then with significant exceptions, coinciding with the implementation of a number of measures on the liberalisation of services and capital flow. In 1970-1980, the ASEAN's activities were limited to sector cooperation only.

In the EurAsEC there is a de facto free trade area, but with numerous exemptions and common practices that, in principle, are not consistent with the rules of the FTA, such as quotas and export duties. The basis of the free trade regime is the legal framework inherited from the 1990's and based on bilateral agreements between member states of the Community. In this regard, there is a need legally to consolidate existing relationships in this region in a multilateral format.

There have been numerous attempts to create a customs union within the CIS, some of these between the five member states of the Community. The latest attempt now under way involves Russia, Kazakhstan and Belarus. It should be remembered that from 2000 until quite recently the coordination of national customs tariffs in these countries was about 60%, which is quite high. At the summit held on June 9, 2009, the heads of governments of the Community managed to agree on full coordination of customs tariffs.

Although the five member states of the EurAsEC have not fully liberalised the movement of goods, they have already signed a number of agreements on the liberalisation (streamlining) of the movement of capital, services and labour, which are in line with the creation of a common market. For example, regarding the movement of labour, we may mention the Agreement on reciprocal visa-free travel of November 30, 2000, and the Agreement regarding the system for mutual recognition and equivalence of academic degrees of September 27, 2005.

The insurance industry has demonstrated particular progress in the service sector: the Agreement on cooperation in the insurance industry of April 27, 2003 and the Agreement on exchange of information between insurance oversight and insurance regulation bodies of September 30, 2004 were successfully implemented. There are also several agreements relating to the regulation of foreign exchange and securities markets (the Agreement on the exchange of information between the competent authorities regulating the securities markets dated December 23, 2003, the Agreement on cooperation in the securities market dated June 18, 2004 and the Agreement on cooperation in organisation of the integrated foreign exchange market dated January 25, 2006).

Moreover, there are trends in cooperation on the freedom of movement of goods that sometimes go beyond the classic understanding of an FTA or CU. Harmonisation of technical regulations is an important step in developing a common market and the Eurasian Economic Community reached agreement on the harmonisation of technical regulations in 2005. Thus, it would be very difficult using classical theory to determine at what stage of economic integration the Community has arrived. The disparities between theory and practice are well illustrated by the opinion of Russian economists: in the EurAsEC "the regulatory environment remains super-liberal compared to other integration processes (as in the case of trade) or uncertain (as in the case of migration or movement of capital)" (Osipov, Pukhov, 2007: 7).

Neither are certain sectoral cooperation activities consistent with the classical model, especially with regard to energy, transport and the use of water resources. Among recent developments that should be mentioned are the establishment of the EurAsEC Centre for High Technology and the EurAsEC "Innovative Biotechnologies" Interstate Target Programme. Sectoral cooperation is also occurring in non-economic spheres, which is unusual for organisations with a low degree of integration: measures are being implemented to protect borders, and there is cooperation in judicial sector including the criminal law.

Finally, in recent years the countries of the Community are actively developing several cooperation projects: the construction of the Sangtuda-1 hydropower plant in Tajikistan and the Kambarata-2 hydropower plant in Kyrgyzstan); the development of Zarechnoye uranium deposit in Kazakhstan; and the construction of an aluminium complex in Kyrgyzstan. Typically, these projects are aimed either at increasing exports, or creating unified production chains in the EurAsEC countries. An important prerequisite for the realisation of such projects was the establishment of the Eurasian Development Bank in 2006, with capital of $1.5 billion.

While sectoral cooperation and realisation of particular projects can only be welcomed, the stability of the integration process, including the sectoral cooperation itself is, in our view dependent upon progress in the field of general economic integration, primarily the creation of a functioning customs union. Uzbekistan left the EurAsEC relatively painlessly. Indeed, the only negative consequence of this country's, actions was its exclusion from multilateral cooperation on water resources management. However, it would be much harder for Uzbekistan to have left a highly effective Customs Union.

It is gratifying that in 2006-2007 the three countries of the Community agreed upon a concept for the Customs Union that meets the most stringent criteria. It requires a common customs territory and common customs duties; it does not allow, as a rule, any tariff and non-tariff regulatory restrictions upon mutual trade; its governance allows for the functioning and development of the Customs Union; it has a common customs regime. It is now time for the practical implementation of the Customs Union.

3. A key feature of the institutional structure of the EurAsEC is its vertical organisation, which implies the approval of decisions on the basis of consensus among the heads of states exceptionally.

The institutional structure of the European Union was originally created with the idea of maintaining a balance between the intergovernmental body (the Council of the European Union) and supranational body (the European Commission). The European Parliament was a later addition to these key institutions and its competence has continuously expanded since the late 1980's. This structure has allowed the institutions to harmonise common (European) and private (national) interests. Moreover, the ability of the European Commission and European Parliament to influence the decision-making process has contributed to balance the interests of different EU countries, easing in particular the dispute settlement between large and small countries, or net donor countries and net recipients. In the EurAsEC there is a clear "vertical power structure": Integration Committee Councils – Commission of Permanent Representatives – Integration Committee – Interstate Council. Historical concern among the former Soviet republics over the question of sovereignty precludes the creation of supranational bodies. The weakness of the parliamentary institutions in each of the Community's countries predisposed to a more facultative role for the Interparliamentary Assembly. In such circumstances, the vertical institutional structure of the EurAsEC was an inevitable outcome. This is not a drawback in itself, but combined with the fact that all binding decisions are made by the Interstate Council, this tends to decrease the efficiency of the legislative process. Moreover, this situation limits opportunities for business lobbyists and other interested parties, which is a disadvantage because lobbyists can often act as a feedback mechanism and provide essential expertise.

At a first glance, it may appear that EurAsEC bodies actively follow qualified majority rule, but detailed analysis shows the opposite. Although member states acknowledge the need to move to majority voting in theory, they are not ready for it in practice. Decisions taken by the Commission of Permanent Representatives are approved by a majority of two-thirds of the votes. However "if there is a dissenting opinion of any of the permanent representatives [...] the question shall be referred to the Integration Committee of the EurAsEC" (Regulations, 2003, article 10). Integration Committee decisions are adopted by a majority of two-thirds of the votes, however the question is referred to the Interstate Council for consideration if "four Contracting Parties have voted in favour of a decision but the decision has not obtained a two-thirds majority" (Treaty, 2000, Article 13), that is, if Russia voted against it. However, the Commission of Permanent Representatives and the Integration Committee prepare only draft decisions and agreements for the Interstate Council to approve, and if they adopt any decisions on their own, the latter are only procedural in nature. The only EurAsEC authority that has the power to make binding decisions is the Interstate Council, which acts only by consensus. Practice shows that even at the level of the Commission of Permanent Representatives voting takes place extremely rarely, and the Integration Committee resolves issues exclusively by consensus[3].

When structured in such a way the decision-making process has several shortcomings.

- The constant search for consensus basically makes any decision very difficult to adopt;
- As practice shows, issues already agreed at lower levels (in working groups, the Commission of the Permanent Representatives or sectoral councils) are often "unpacked" and discussed again at the Integration Committee and the Interstate Council[4];

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[3] *Interview with a senior official of the Secretariat of the EurAsEC Integration Committee.*
[4] *Interview with a senior official of the Secretariat of the EurAsEC Integration Committee.*

- Even when there is no dissent, the decision-making process has to go through every body from the working group to the Interstate Council which, in accordance with the regulations, takes one and a half years (Shurubovich, 2006: 184) - a very long time;
- The institutional structure of the Eurasian Economic Community has created a gap between the two channels of decision-making: the Integration Committee Secretariat, the Commission of Permanent Representatives and the Integration Committee on the one hand, and EurAsEC subsidiary bodies (sectoral councils and commissions) on the other. There are serious doubts regarding the ability of the Commission of Permanent Representatives to coordinate the work of subsidiary bodies, and the Integration Committee meets too infrequently to perform this function effectively. This makes it difficult to combine individual decisions and to form a compromise packages.

One favourable development was the establishment of a Customs Union Commission (CUC) by the EurAsEC Customs Union. This body is empowered to make decisions by a majority of two-thirds of the votes and, where there is disagreement, is not required to refer the decision to the Interstate Council. The votes are distributed between the three countries as follows: Russian Federation – 57%; Belarus – 21.5%; Kazakhstan – 21.5%.

The relatively broad mandate of the CUC is to "act as a standing regulatory body of the Customs Union" and "within the limits of its competence ensure the implementation of international treaties constituting the contractual and legal framework of the customs union" (Treaty, 2007, articles 1, 6). The EurAsEC Interstate Council (Customs Union supreme body) approved a limited list of "sensitive issues" on which the CUC should decide unanimously. This is an important step forward because it means no individual country has the power to block a decision on issues not included in the abovementioned list[5]. Time will tell how extensive the CUC competences will be, and how often majority vote will be used in practice.

4. Another significant disadvantage of the institutional structure of the Eurasian Economic Community is the absence of any authority that would serve to protect the common interests of the Community. In the European Union such authorities are the European Parliament and the European Commission, however, in the EurAsEC neither the Interparliamentary Assembly nor the Customs Union Commission can claim to represent the common interest.

The weakness of the IPA is determined by political situation in member states as well as by the extremely limited competence of this body. The

[5] *The management of the Customs Union would be impossible without such a mechanism.*

EurAsEC IPA is composed of deputies delegated by the parliaments of EurAsEC member states. Given that the legislative authority of the member states is de facto dependent on the executive powers, the ability of the IPA to play an independent role is open to question. As for the competence of the IPA, it is not involved in the EurAsEC decision-making process (there is no mechanism for mandatory consultation). Currently, the role of the IPA is limited to developing model codes and laws and drafting proposals for the fundamentals of legislation of the member states.

The Customs Union Commission is theoretically a supranational body, but it is still not able to function as a representative of the common interests of the Community. The supranational authority must meet several criteria:

- it should have its own competence, conferred on it by member states;
- it must not make decisions by consensus;
- decisions must be binding, including for any state that objected to the decision;
- decisions should enter into force without any action at national level (e.g., ratification or approval in some form).

Our analysis of existing documents suggests that the CUC meets these criteria. However, its structure does not allow it to be considered as a representative of the common interests of the Community. Members of the European Commission act as individuals, independent of national governments, and do not request instructions from their governments. Members of the CUC are there because they hold an official post – deputy prime minister or minister – in a member state government and therefore they must defend the national interests of "their own" state. There is moderate optimism for the future evolution of this body based on the treaty provision that "the number of the Parties' representatives in the Commission and their status may be altered upon completion of the customs union establishment." (Treaty, 2007, article 4) It remains to be seen how the Eurasian Economic Community Customs Union will balance the two fundamental requirements for its institutional structure, i.e., transfer of powers in trade policy to the supranational level, without which the CU cannot function; and ensuring that the institutions can harmonise the vital interests of individual member states and prevent decisions being sabotaged at the national level.

5. The way in which the Eurasian Economic Community's decisions have been implemented leaves a great deal to be desired, which raises the question of how to establish effective mechanisms for enforcing decisions and monitoring their execution. This problem is undoubtedly a preoccupation of certain higher officials of the Community and its

> member states. The chairman of the Interparliamentary Assembly, M. Ubaidulloev, (2008: 8) on behalf of the IPA, emphasized the need to "develop proposals and norms of the treaty establishing the Eurasian Economic Community as it relates to exercising control over fulfilment of the Community's decisions on national and international levels, as well as defining the criteria of the parties' economic responsibility if they fail to fulfil its obligations."

Today there are two ways in which decisions can be adopted in the Eurasian Economic Community: by the decision proper of the Interstate Council and by international agreement signed at the meetings of the Interstate Council. There is practically no difference between these methods in terms of the order of their implementation: international agreements must be ratified by all member countries in accordance with national procedures; decisions of the Interstate Council shall be implemented by the member states "by adoption of the necessary national regulatory instruments, in accordance with national legislation." (Treaty, 2000, article 14) Another evidence that these two types of documents have much in common is the fact that decisions of the Interstate Council are not signed by the Chairman but by all members of the Interstate Council[6]. The execution of decisions is entrusted to the heads of the member states' executive authorities. Thus, the implementation of Community decisions into national law takes place at the national level (since the EurAsEC law has no direct effect) and in the absence of any strict monitoring.

For the five member countries, this problem is mitigated by the fact that the majority of Interstate Council decisions are concepts, strategies or agreements containing mainly "soft law" provisions and therefore these decisions cannot conflict with national legislation. They tend to establish rights and obligations only for the participating countries, but not for individuals or legal entities. However, the CU has created a significant body of legislation that should be applied by national courts and executive bodies. The activities of national executive authorities should be subject to external monitoring, otherwise the legislation of the Eurasian Economic Community risks becoming a bare right.

Such external monitoring may be either judicial or political, but ideally these two forms of monitoring would be combined, mutually reinforcing each other.

Since 2003 the CIS Economic Court of Justice has performed the functions of the EurAsEC Community Court of Justice. However three factors limit the role of the Community Court.

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[6] Chairman of the Interstate Council signs only the organisational and protocol papers.

Firstly, it has a relatively narrow jurisdiction in rem. The Court can examine Eurasian Economic Community treaties only if the latter contain a special clause. At the end of 2010 the court could adjudicate disputes in 57 of the Eurasian Economic Community agreements, forty of which relate to the CU, and its decisions are binding only for the three countries of the Community.

Secondly, the Court has limited jurisdiction in personam: the Community Court is not empowered to examine claims made by individuals. It should be noted that the power of the EU Court of Justice to consider claims from private persons was one of the most important "engines" of integration in the EU. Appropriately with the establishment of the CU, the Community Court Statute was amended in 2010. In particular, the court received the power to consider the complains of economic entities of Customs Union member-states about the infringement of CU law (Statute, Article 14).

Finally, it is not entirely clear what the legal implications of the decisions of the Community Court of Justice are. On the one hand, court decisions are final and without right of appeal. However, they are binding only for the parties to the dispute. Theoretically, therefore, the state that did not participate in the dispute may continue practices deemed to be illegal. Moreover, there is no clear mechanism for the enforcement of court decisions because they are not incorporated into the national legislation of the member states. Theoretically, in case of default on a court decision, any party to the dispute may apply to the Interstate Council. But this would seem wholly unrealistic if "an economic entity" was the plaintiff. Another weakness of the court is its lack of communication with the national courts, since national courts are not obliged to consider decisions of the Community Court of Justice. Although the highest judicial bodies in member states are entitled to apply to the court with queries on the interpretation of Eurasian Economic Community legislation, they are not obliged to do so. Thus, the national courts are tempted deliberately to ignore the laws of the Community.

This is strikingly different from the legal procedures of the EU Court of Justice: if the national law is deemed to be inconsistent with EU law it is automatically stopped to be implemented by the national courts and authorities. The role of the Community Court of Justice is illustrated well by the fact that during the ten years that the Eurasian Economic Community has existed, the Community Court considered only one case!

In any case, judicial monitoring is time consuming and very expensive financially, and it should therefore be used only in extreme cases. Political monitoring is a much more efficient tool for day-to-day operations. Theoretically, political monitoring may take the form of either regular reports of the executive authorities of member states to EurAsEC bodies or the compilation of complaints filed with relevant national authorities by economic entities. The latter method would be used where a firm in country A, operating in country

B, encounters a violation of EurAsEC legislation by country B authorities and complains to the authorities of its native country A. The authorities in country A register the complaints and file them for the relevant bodies of the Community. The CUC and its subsidiary bodies, it is hoped, through regular discussion, would effectively resolve the problem of the failure to implement decisions. In this context, the sensitive issue of potential non-compliance could be discussed without undue politicisation. This method of political monitoring might be especially efficient because in practice the ministers and heads of other national authorities play a key role in the enforcement of decisions: "what is important is the will of national ministers.[7]"

Given the limited power of the Community Court and the degree of ambiguity regarding the legal status of its decisions, the political mechanism of mutual control in the course of subsidiary bodies, is, in fact, the only option. All the same, it should be said that political monitoring requires a high level of mutual trust.

Conclusions

Based on our analysis we have been able to formulate a number of recommendations for improving the institutional structure of the EurAsEC and for the development of integration processes at large. Recommendations are based not necessarily on what is desirable, but on what is possible given existing economic relations between the Community's member states, their current level of integration, and their internal political and economic situations.

1. Active cooperation in specific sectors should continue, especially in those sectors where there are interested partners (energy, transport). It is important to give preferential treatment to industrial cooperation, technology transfer and investment cooperation. Measures to reduce competition at the markets of third countries, including coordinating pricing and delivery volumes (e.g., in the fuel and energy complex, metallurgy, chemical industry), should have a major impact[8].
2. Alongside the implementation of sectoral programmes and certain projects, financial solidarity must be strengthened, for example, by requiring a minimum contribution even from member states of the Eurasian Economic Community that have no direct interest in certain projects. In future, it would be useful to increase the budget and to fund projects out of the common budget. Otherwise, the implementation

[7] Interview with a senior official of the Secretariat of the EurAsEC Integration Committee.

[8] We should follow the example not only of the EU but of other integration organisations. For example, within the ASEAN there is an association of coffee producers.

of measures will regularly be compromised by the need to conduct complex negotiations each time about the contributions required from member states.

3. It should be clearly understood that the future of the EurAsEC depends on the efficacy of the Customs Union between the three member countries and movement toward the Common Economic Space (CES). Nevertheless the desire to hasten the development of the CES should not lead to "loss of quality".
4. The work of the Customs Union should not be confined to issues of foreign trade. All countries benefit from establishing the Common Economic Space, but these benefits are unevenly distributed. The countries with the most competitive economies obtain the greatest positive impact. The interests of less competitive countries should be supported through "compensatory" regional or industrial policies. Such policies should be implemented at the supranational level (for example, by giving appropriate powers to the CUC) and financed by the common budget. The presence of a "compensatory" policy may give the rearguard countries an additional incentive to join the Customs Union.
5. The CUC should operate initially according to two principles: strict adherence to the practice of adopting decisions by majority in those areas where it is stipulated, and taking into consideration the interests of the countries opposing the adoption of certain decisions on the basis of their national interests. As a rule, the adoption of the decision should be by majority, otherwise it would be impossible to operate the CU. However, this should not "intimidate" participating countries, otherwise they may attempt to sabotage the common decisions.
6. It would be desirable to transform the CUC into a body that can uphold the common interests of the Community, which is possible only by changing the fundamental principle of its forming. This is an extremely difficult step, but the possibility of such a transformation is provided for in the signed Treaty on the CUC.
7. Within the structure of the EurAsEC it would be beneficial to consider the possibility of transferring the right to make certain decisions from the highest level (the Interstate Council) to the Integration Committee and the subsidiary bodies. This will significantly reduce the time it takes to make decisions (by allowing decision-making by qualified majority), which in turn will make member states more inclined to compromise.
8. It makes sense to involve the Interparliamentary Assembly in the preparatory process of decision-making of the Interstate Council. Currently, the best possible way for the IPA to participate is through a system of regular mandatory consultations. It would be helpful to

coordinate legislative plans for the IPA with the prospective activities of the EurAsEC.

9. Enactment of the Customs Code in 2010 has revealed a lack of effective communication between the bodies of the EurAsEC and the business community. The potential of the existing Eurasian Business Council had not yet been fully realised. Information flow should be two-way: EurAsEC bodies might demonstrate greater transparency, thus providing a stable and predictable regulatory environment, and could increasingly rely on the expertise and advice of the business community in drafting decisions.

10. To increase the effectiveness of the institutional structure of the EurAsEC it is essential to improve coordination between the sectoral councils. There are two possible solutions, which could be implemented simultaneously. The first solution is to hold joint meetings of two or three councils on issues of related competencies. Secondly, similar sectoral councils could be merged on a permanent basis. Interaction between sectoral councils will not only enhance the consistency between the decisions taken and the overall objectives of the Community, but would also create an opportunity for legislative proposals to be bundled so that effective compromises can be considered.

11. The more numerous the EurAsEC legislative acts would be, especially that of the Customs Union, the more the quality of implementation of decisions at the national level may become the "achilles heel" of the EurAsEC. In this regard, it makes sense to consider increasing the role of the Court of Justice of the Community by enhancing its links with the national courts. However, this is a long-term problem which can only be solved with the judicial reform at national level.

12. EurAsEC decisions should be streamlined and their legal force and role in national law of member states should be clarified. It is also desirable to formalise the existing mechanism for political monitoring of the execution of EurAsEC decisions at national level. The best solution for this would be to give the CU Commission and sectoral councils oversight powers.

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7 On Possibility of Artificial Currency Devaluation Within the Customs Union*

Evgeny Vinokurov, Elvira Kurmanaliyeva

Introduction

After Japan's currency interventions in September 2010, the overall view was that a "devaluation race" had begun, i.e. a situation where countries strive to weaken their currencies so that their economies can gain a competitive advantage. However, the IMF head promptly responded to these statements, saying he sees no threat of a global currency war.

The recent currency interventions by a number of countries can be viewed as a form of protectionism. After World War I, some governments adopted such a policy in order to preserve jobs and protect domestic industry. However, these governments refrained from making more decisive steps towards economic restructuring such as wage cuts or reforms aimed at enhancing labour productivity. Nowadays, currency interventions are largely a means of preventing currencies from rapid strengthening rather than artificial devaluation.

Artificial devaluation entails an increase in exchange reserves and a soft monetary policy. The latter may in turn result in non-optimum distribution of capital and pave the way for bubbles in the housing and other asset markets. Efforts to weaken a national currency at all costs are counterproductive, especially where several currencies are being devalued simultaneously. In such a situation, the price of gold and other precious metals and raw materials will increase, and all participants in a devaluation race will eventually lose, as will all third parties, due to stricter protectionist policies, shrinking international economic cooperation and potential setbacks in the global financial system. Any benefits of devaluation for each individual country will be wiped out by similar actions by neighbouring countries.

At the summit in November 2010 in Seoul, the heads of the G20 agreed that any "war" in this sphere, or any artificial devaluation of national currencies, is inadmissible. Although no direct measures against low exchange rate policies were promulgated, the parties agreed to control swift or chaotic

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** "This paper has been written in November 2010, and only focuses on a possibility of competitive devaluation within the Customs Union. Nevertheless, a Belarusian currency crisis that ended up with a 56% devaluation in May 2011 to some extent confirms our proposition that none of the CU members would have an interest in artificial devaluation of national currency".*

exchange rate fluctuations, to move towards currency systems that would reflect market fundamentals, and to give up competitive devaluation of their currencies. This further indicates their understanding of the harm such protectionist policies may bring about. It is therefore premature to talk about the start of a devaluation race.

In December 2010 the heads of the three Customs Union countries (Russia, Kazakhstan and Belarus) signed the fundamental documents to form the Common Economic Space (CES). With the inception of the Customs Union, the issue of unilateral currency devaluation by any one member becomes even more pressing. What are the prospects for such behaviour, and what consequences would artificial devaluation have in Customs Union states? In this paper we attempt to answer these questions. The next section discusses recent trends in the formation of national currency exchange rates in these three countries. Section III discusses the probability of competitive devaluation. Section IV provides an insight into the effects of real devaluation on trade flows. The last section summarises our analysis.

The foreign exchange policy in the Customs Union

Should a country have to fix its national currency exchange rate or, quite the opposite, allow it to float freely? Maybe the Customs Union members should form a monetary union with the neighbouring countries and adopt a common currency, as did the European Union? All these forms of currency regime have already been tested. The ability of a monetary union to stand up to currency wars depends on the situation in each individual country or union.

A monetary union is the most definite form of fixing currency exchange rates. Its most obvious advantage is the stability of the exchange rate. Unlike under a volatile floating exchange rate scenario, the stability of a common currency works to reduce exporters' risks. Another important advantage is that union members are unable to interfere with the currency market to promote the artificial devaluation of their currencies against those of their partners. A monetary union also has a number of drawbacks. The most notable is the loss of independence in macroeconomic policy making. No central bank in a union can raise or reduce its official rate without consulting its counterparts. If business cycles in union countries are fully synchronised, this process is easy. But where countries need different monetary policies, as is the case with Greece in the European Union, this can pose major problems.

From the perspective of the macroeconomic synchronisation of the Customs Union states, calculations using the System of Indicators of Eurasian Integration (SIEI)(EDB,2009) *in Figures 7.1.* and *7.2.* suggest that there is no trend towards the macroeconomic convergence of post-Soviet states. The leaders in terms of convergence are small groups, first of all EurAsEC-3 (the Customs Union). The second decade since the disintegration of the Soviet

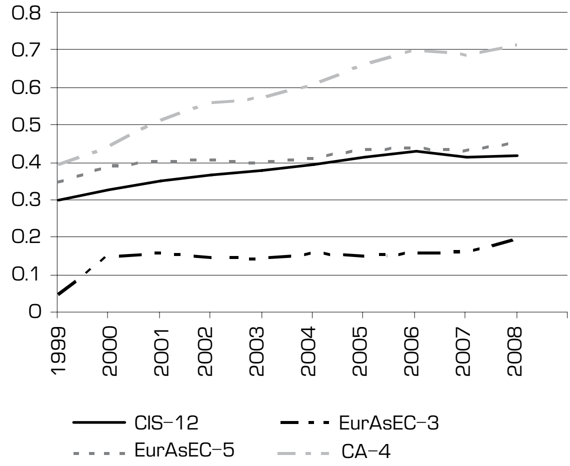


Figure 7.1. Macroeconomic convergence

Note: An increase in the index corresponds to lowering of the convergence level

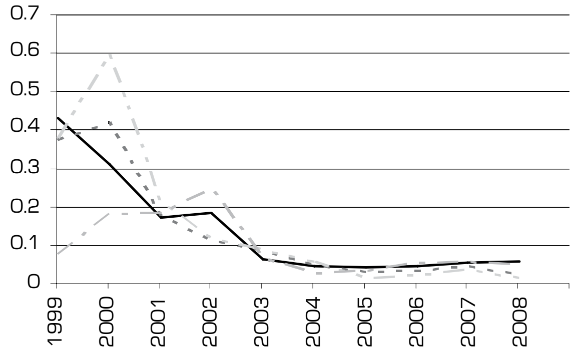


Figure 7.2. Monetary convergence

Note: An increase in the index corresponds to lowering of the convergence level

Union saw the convergence process in all the five post-Soviet country groups. This convergence was driven by similarities in the monetary and credit policies of all countries in the region and, to some extent, trends in the global currency market.

In December 2010 the heads of the Customs Union states met in Moscow to discuss the formation of a Common Economic Space, which is expected to take place in 2012. To this end, a package of documents was signed on various aspects of economic cooperation between Russia, Belarus and Kazakhstan within the CES framework. These documents will become law after ratification by each member state. The most important among the 17 agreements are those pertaining to the coordination of macroeconomic and monetary policies. Macroeconomic coordination will include agreeing currency exchange rates and foreign debt, inflation and budgetary deficit levels; and monetary coordination will include agreeing currency interventions and mutual settlement in national currencies. The initial version of this agreement provided for closer cooperation in monetary policy making, but then central banks voiced their concerns about losing independence in implementing these policies. The issue of a common currency has not been discussed so far.

Is a currency war in the Customs Union possible?

How instrumental can devaluation be in securing a competitive advantage for any of the Customs Union state? To answer this question we need to make a distinction between nominal and real devaluation (i.e. the slumping of a national currency exchange rate), artificial devaluation caused by central bank interference with the currency market, and natural devaluation resulting from a country's macroeconomic situation.

Real bilateral exchange rates (RER) and real effective exchange rates (REER)[1] reflect actual changes in the standing of a currency and competitiveness of a country. The dynamics of REER and RER in the Customs Union states, as shown *in Figures 7.3.* and *7.4.*, have several notable trends. In the period from 2001 to 2009, REER was increasing in Russia and Kazakhstan, which means a trend towards more expensive exports and poorer competitiveness. Belarus' REER was declining steadily, making the country's exports more competitive.

The mechanism of nominal artificial devaluation is as follows: a country replenishes its foreign exchange reserves by buying foreign currency on

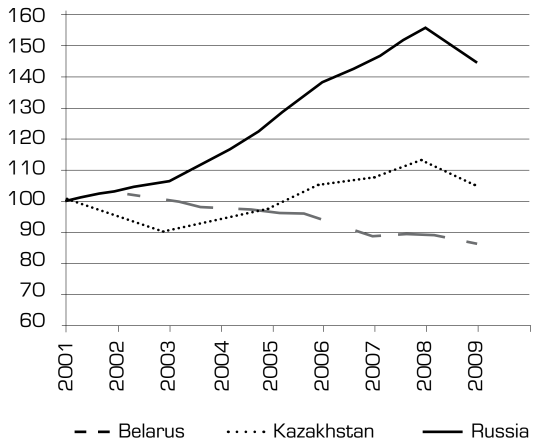


Figure 7.3.
REER (2001=100)

Sources: IFS, IMF and the central banks of Russia, Belarus and Kazakhstan.

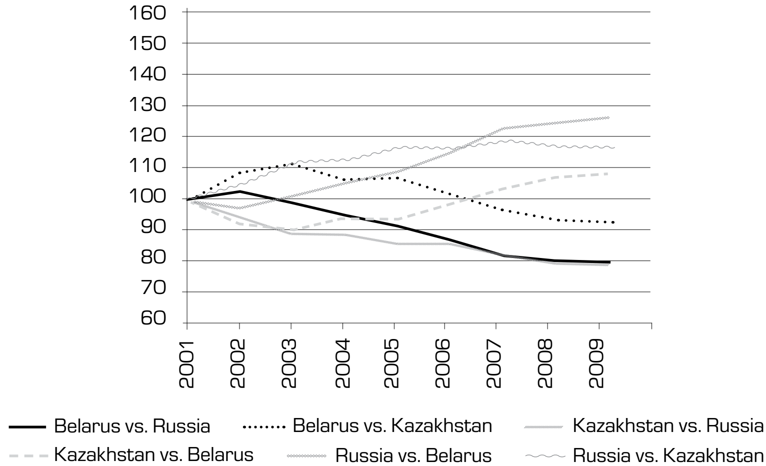
Note: Upward movement indicates real currency strengthening

[1] *REER is calculated as average real exchange rate of the currency of country C against the currencies of all trade partners P:* $REER_C = \sum_P B_P^C \times \frac{Pr_C}{Pr_P \times K_P^C} = \sum_P B_P^C \times RER_{PP}^C$ *, where* B_P^C *– share of partner P in trade with country C;* Pr_C *– prices in country C;* Pr_P *– prices in partner country P; and* K_P^C *– exchange rate.*

Figure 7.4.
RER (2001=100)

Sources: IFS, IMF and the central banks of Russia, Belarus and Kazakhstan.

Note: Upward movement indicates real currency strengthening



the market, which enables it to issue more national currency and create conditions for nominal devaluation.

In the short term, artificial devaluation will make national exports cheaper compared to those of other countries and encourage growth in demand for the country's products. These effects are much weaker in industries whose product cost structure is dominated by imported components. However, apart from these benefits for exporters, devaluation of this sort entails some negative consequences. Particularly, devaluation of the national currency renders loans denominated in foreign currency expensive for domestic borrowers. Countries with huge foreign debt may also face problems caused by significant devaluation (this is relevant to Belarus, since its foreign debt accounts for 52% of GDP and is growing rapidly). In countries with historically high inflation levels, artificial devaluation and an excessive supply of money may escalate inflation. On the whole, the real exchange rate of a currency does not change in the medium term. In other words, manipulating exchange rates does not bring about any improvements in competitiveness in the long and medium term, and the costs of artificial devaluation exceed the short-term benefits.

Let us look into the dynamics of five indices (compared to the same month of the previous year) for each country: central bank currency reserves, supply of money M2, exchange rate vs. the US dollar, consumer price index (CPI) and manufacturers' price index (MPI).

As is shown *in Figures 7.5* and *7.6*, the monetary mass in Russia changes almost in parallel with currency reserves. Thus, in 2001-2010 monetary mass was growing by 35% per annum on average, resulting in growth in manufacturers' prices. An insignificant change in the nominal exchange rate

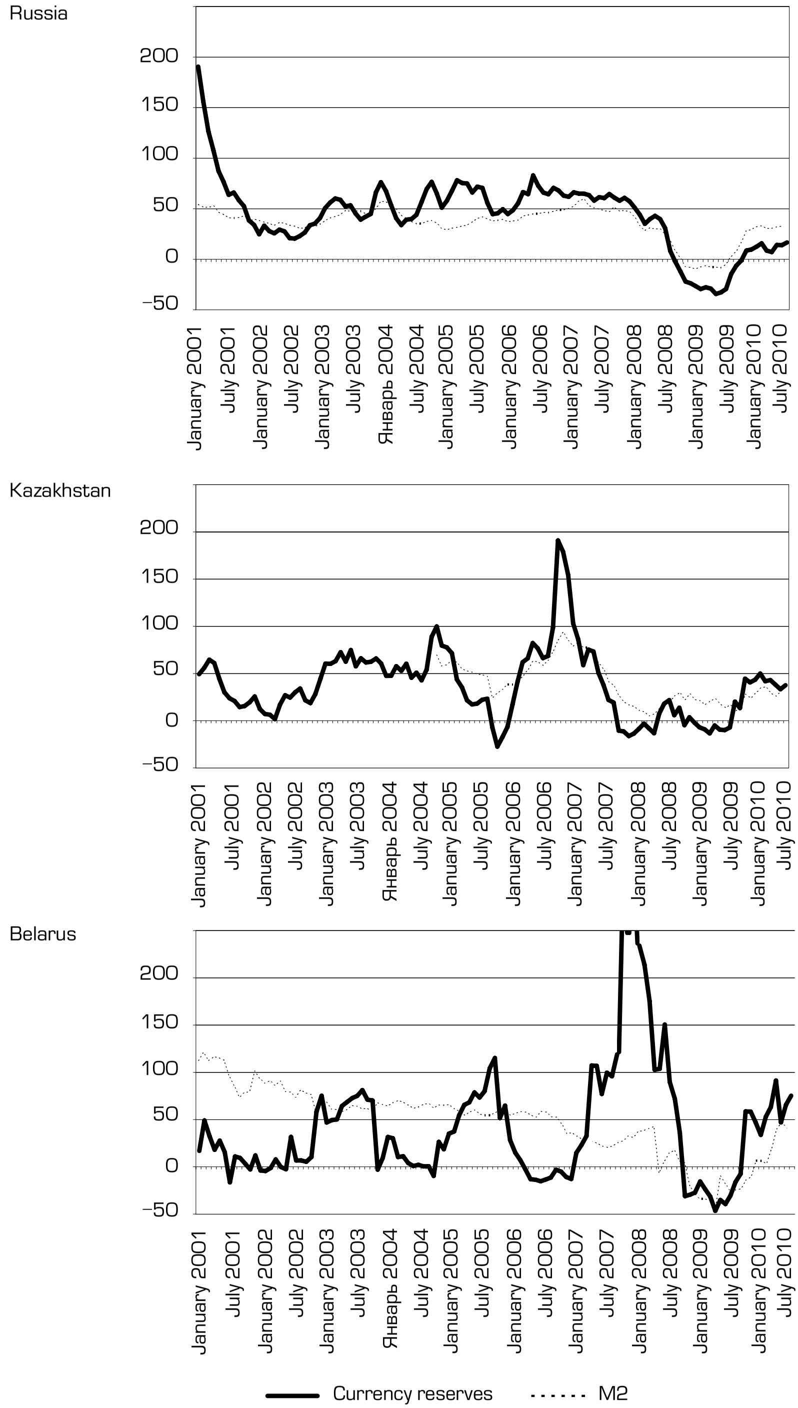
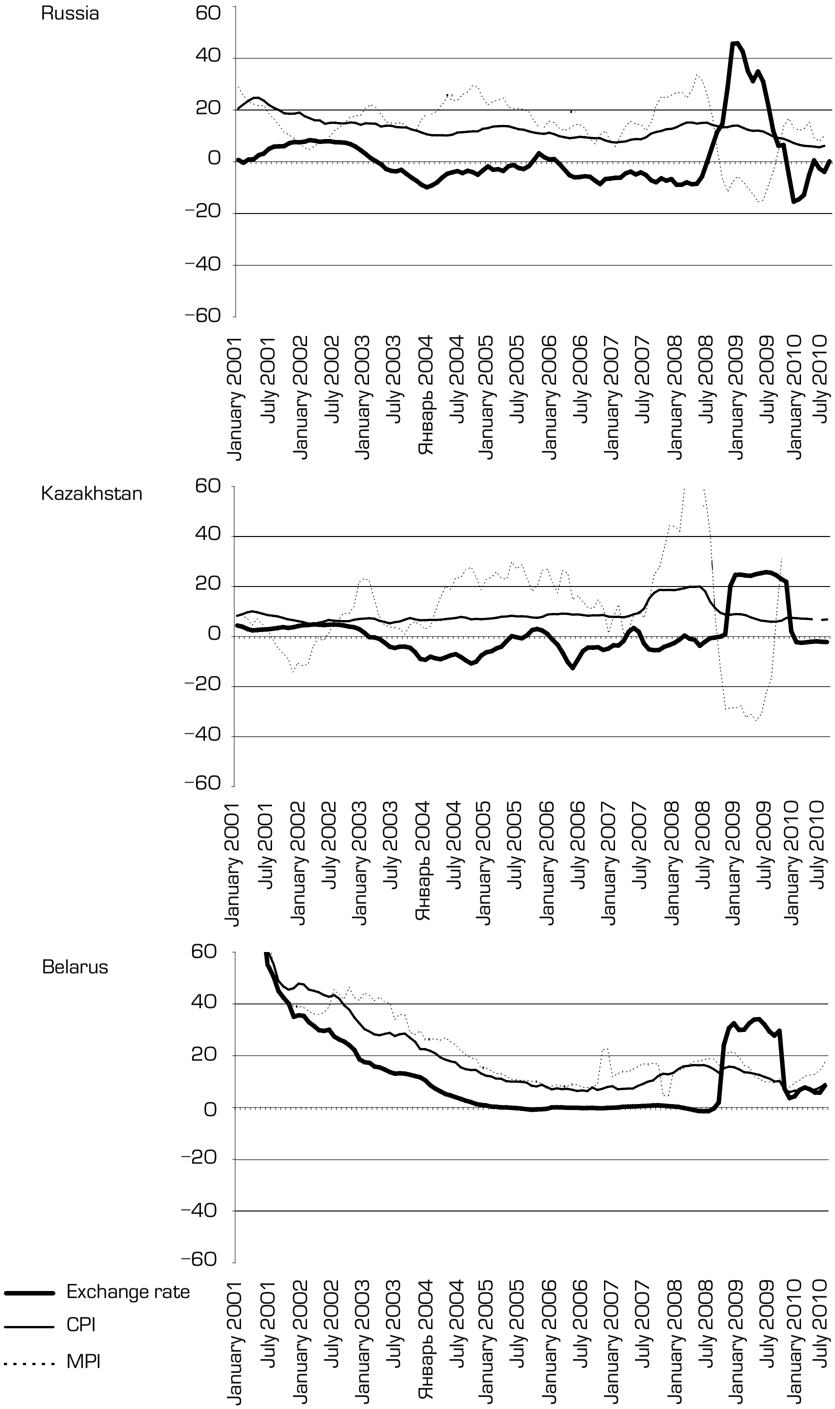


Figure 7.5.
Changes in central bank currency reserves and monetary mass M2 (%)

Sources: IFS, IMF and the central banks of Russia, Kazakhstan and Belarus

Figure 7.6.
Changes in the exchange rate, CPI and MPI (%)

Sources: IFS, IMF and the central banks of Russia, Kazakhstan and Belarus



caused gradual real strengthening of the rouble (i.e. an increase in REER) and deterioration of competitiveness.

The situation in Kazakhstan is largely identical, apart from volatility: currency reserves were growing by 37% per annum on average throughout the period under review. This resulted in a 40% growth in monetary mass and an 11% growth in manufacturers' prices. The exchange rate of the Kazakh tenge strengthened somewhat in real terms, albeit to a lesser extent than that of the Russian rouble.

The Belarusian economy differs significantly in this respect from the Russian and Kazakh economies. From 2005 to mid-2008 the Belarusian rouble was fixed against the US dollar, and currency reserves were replenished largely by external borrowing. Therefore, the diagram does not reflect the correlation between changes in money supply and changes in currency reserves. Nevertheless, the expansive monetary and credit policy in 2001-2006 created conditions for an average 34% growth in manufacturers' prices.

After devaluation of the national currency in 2009 the Central Bank of Belarus introduced a regulated floating rate, thus creating conditions for correlation between currency reserves and the monetary mass (see figure 7.5) and the emergence of inflation pressure in early 2010 (see Figure 7.6). As a result of considerable nominal devaluation of the Belarusian rouble against the currencies of trade partners (namely, Russia) Belarus' REER gradually declined throughout 2001-2009.

During the 2009 crisis, nominal natural devaluation of the Russian rouble, Kazakh tenge and Belarusian rouble peaked at 47%, 25% and 36% respectively (see Figure 7.6); devaluation against the US dollar in that year averaged at 28%, 22% and 30% respectively.

A higher rate of this devaluation compared with other Customs Union states improved the competitiveness of Belarus' exports in 2009 by 1.1% on average (*Figure 7.4* shows a decline in real bilateral exchange rates of Belarus vs. Russia, and Belarus vs. Kazakhstan).

What are the prospects of artificial devaluation of the Belarusian rouble in the near future? Belarus will probably not need to resort to such a measure in order to maintain competitiveness on the markets of its partners in the Customs Union, as their "raw material" currencies will do this job for Belarus (the rouble and the tenge are likely to strengthen). An important factor that will fuel inflation in Belarus in the near future is the expansive monetary and credit policy; it has been pursued since May 2010 and was partially responsible for a 6% increase in GDP in the first nine months of 2010. This policy also resulted in a significant increase in foreign debt and the cost of labour, and is expected to dramatically reduce Belarus' competitive advantage and devalue its currency even further.

Our analysis of data confirms that none of the Customs Union countries can artificially devalue its currency in order to improve competitiveness in the medium and long term, because any currency intervention results in an increase in the monetary mass and pressure on prices. Artificial manipulation of the exchange rate can only bring about short-lived growth in demand for exports, but then pressure on prices adjusts the real exchange rate of the national currency.

What are the consequences of *real* devaluation?

As we have mentioned in the previous section, a country cannot make its exports more competitive by means of artificial devaluation. A real exchange rate, which indicates a country's competitiveness, is determined solely by macroeconomic policy and the changing situation on external markets.

Any change in competitiveness (e.g., real currency devaluation) must change (increase) demand for the country's exports. Let us look into a connection between exports and real exchange rates in the Customs Union states. *Table 7.1* shows the ratios of correlation between real bilateral exchange rates and export flows, by commodity group. Commodity groups that account for at least 10% of a country's total exports to any importing country are marked bold. Grey cells contain net export commodity groups in 2001-2009. Since, in accordance with economic theory, real devaluation is beneficial for a country's exports, the correlation ratio value must be negative. A higher ratio indicates closer correlation between exports and real exchange rate[2].

For Russian exports, a positive correlation ratio means that real devaluation of the rouble is unlikely to further Russian exports considerably, as the Russian economy is heavily dependent on export of resources, which prices are dictated principally by the global situation. Real devaluation will not influence the competitiveness of Russian exports.

The situation is different in Belarus: correlation ratios are negative in all industries, however, just like in Russia and Kazakhstan. A positive trade balance in many commodity groups indicates Belarus' strong competitive advantage over its partners in the Customs Union. If the competitive conditions of trade with Russia improve, Belarus' food, textile, shoes and mechanical engineering will have an advantage. Belarus is a net exporter in trade with Kazakhstan and has a competitive advantage in practically all non-raw-material commodity groups.

Kazakhstan has a negative correlation value in trade with Russia and in some commodity groups exported to Belarus. Particularly, improved competitiveness in trade with Belarus will benefit textiles and shoes,

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[2] Notably, since ratios were computed based on the annual values of nine years (2001–2009), correlation ratios are statistically insignificant.

HS code	Commodity group	Russian exports to Kazakhstan	Kazakh exports to Russia	Belarusian exports to Kazakhstan	Kazakh exports to Belarus	Russian exports to Belarus	Belarusian exports to Russia
01–24	Food and farm produce	0.82	**–0.61**	**–0.79**	**0.31**	0.6	**–0.94**
25–27	Minerals	**0.83**	**–0.78**	–0.59	0.76	**0.98**	–0.42
28–39	Chemicals	**0.84**	**–0.82**	–0.77	0.84	0.86	–0.92
40–43	Rubber	0.85	–0.83	**–0.68**	0.28	0.52	–0.96
44–49	Timber and paper	0.87	–0.58	–0.57	0.57	0.75	–0.76
50–67	Textile and shoes	0.9	–0.61	–0.55	**–0.34**	0.75	**–0.79**
68–71	Cement, glass and precious metals	0.87	–0.59	–0.08	0.6	0.62	–0.83
72–83	Iron and steel	**0.87**	**–0.82**	–0.64	**0.81**	**0.81**	**–0.8**
84–85	Electric machinery and equipment	**0.82**	–0.86	**–0.54**	0.54	**0.67**	**–0.87**
86–89	Cars and transport equipment	**0.82**	–0.55	**–0.46**	–0.33	0.73	**–0.64**
90–93	Instruments and optic equipment	0.86	–0.67	–0.68	0.43	0.56	–0.76
94–97	Furniture, toys and sport equipment	0.88	–0.52	–0.59	–0.44	0.52	–0.83
99	Others	–0.26	–0.33	–0.43	0.39	0.91	–0.93
	Total	0.85	–0.8	–0.62	0.73	0.95	–0.89

Table 7.1.
Ratios of correlation between exports and real bilateral exchange rates in the Customs Union (in 2001–2009)

Source: computed based on IFS, IMF and TradeMap International Trade Centre statistics

transport equipment, furniture and sports equipment. On the whole, these industries are of little significance for the economy.

Therefore, calculations of simple correlation ratios indicate that Belarusian exports have an advantage over the exports of Russia and Kazakhstan. Being a net exporter of food and electric and transport equipment to Russia and Kazakhstan, and having a competitive advantage in these commodity groups, as well as pursuing flexible monetary and credit policy, Belarus can secure long-term growth in exports within the framework of the Customs Union. The Russian and Kazakh economies depend principally on exports of raw materials and therefore are not sensitive to parity changes in the prices of export products.

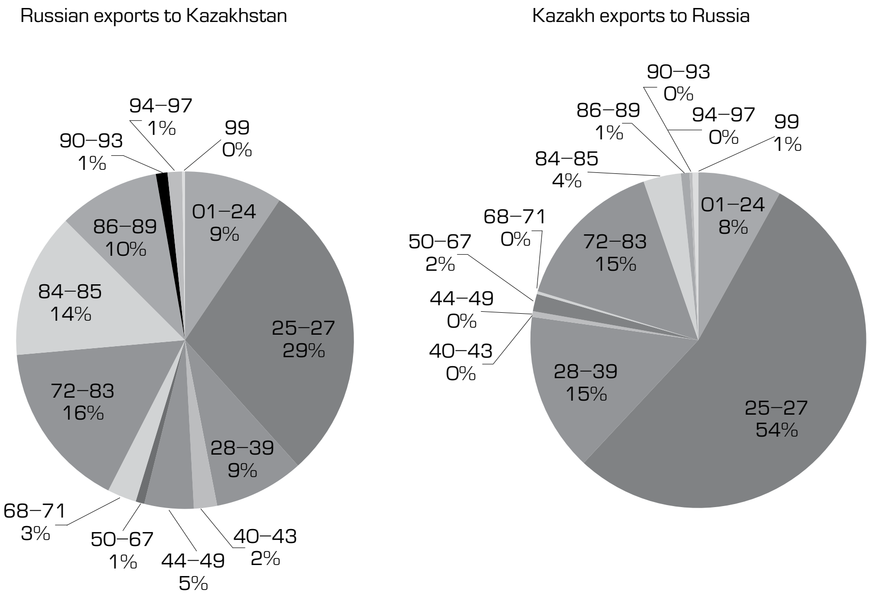
Conclusions

Artificial devaluation is not in the interests of the Custom Union members. Our analysis of data confirms that none of the Customs Union countries can artificially devalue its currency in order to improve competitiveness in the medium and long term because any currency intervention results in an increase in the monetary mass and pressure on prices. Artificial manipulation of the exchange rate can only bring about short-lived growth in demand for exports, but then pressure on prices adjusts the real exchange rate of the national currency.

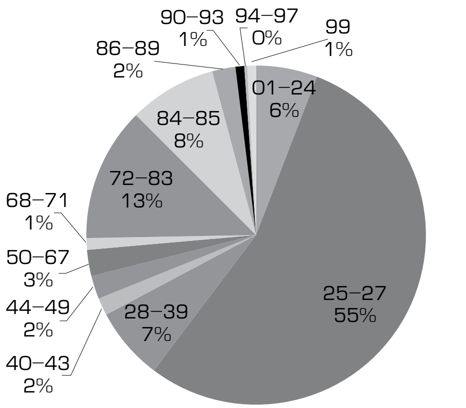
The flexibility of export prices means that exports are inversely proportional to the real exchange rate, i.e. a comparative growth in prices must result in a decline in demand for exports. A simple correlation calculation based on nine years of annual data showed an inverse relationship between bilateral exports and real exchange rates of the Russian and Kazakh currencies, which reflects the raw material orientation of these economies. The most important commodity groups of Belarus have negative correlation ratios, which indicates that Belarus has good prospects for growth in exports; this country trades mainly in non-raw-material products with its Customs Union partners.

Of course, the Customs Union economies differ from each other in macroeconomic structure. Therefore, the formation of the Common Economic Space will require a well-balanced approach towards concerted macroeconomic and foreign trade policy making.

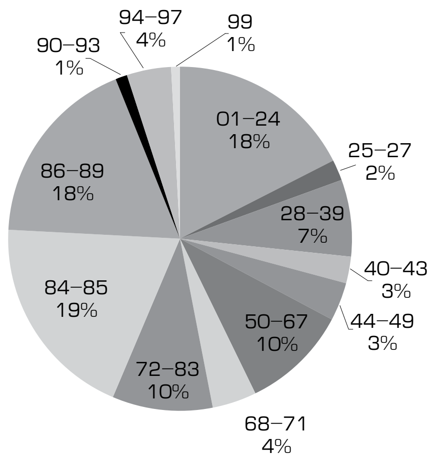
Annex 7.1. Structure of foreign trade within the Customs Union (%)



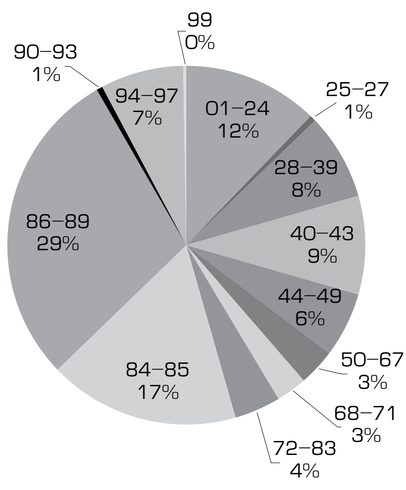
Russian exports to Belarus



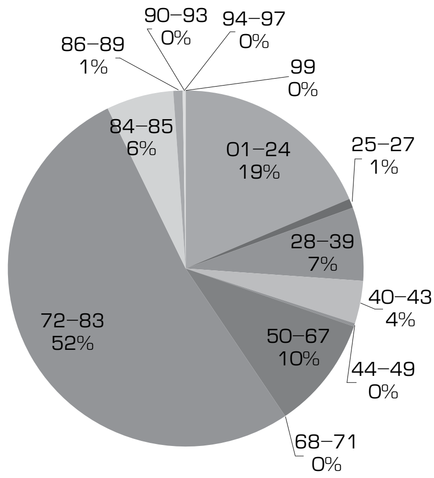
Belarusian exports to Russia



Belarusian exports to Kazakhstan



Kazakh exports to Belarus



Source: TradeMap

Note: codes are given in accordance with the Foreign Trade Commodity Codes: 01–24 – food and farm produce; 25–27 – minerals; 28–39 – chemicals; 40–43 – rubber; 44–49 – timber and paper; 50–67 – textiles and shoes; 68–71 – cement, glass and precious metals; 72–83 – iron and steel; 84–85 – electric machinery and equipment; 86–89 – cars and transport equipment; 90–93 – instruments and optic equipment; 94–97 – furniture, toys and sport equipment; 99 – others.

8 The Stock Markets of Russia and Kazakhstan: Prospects for Integration

Natalia Maqsimchook (EDB), PARTAD

EDB Sector Report No.10

Main Conclusions

This study, conducted by the Eurasian Development Bank with support from the Professional Association of Registrars, Transfer Agents and Depositories (PARTAD), provides an assessment of the prospects and challenges of integration of the capital markets of Russia and Kazakhstan. Our analysis of the legal framework for mutual penetration of Russian and Kazakhstani capital in the form of stock market instruments shows that there are no insurmountable barriers to this process. Moreover, the basic legal preconditions for this mutual penetration are all in place. However, as the financial crisis persists and the capital markets of Russia and Kazakhstan fail to function as a single financial centre in the global financial market, these established preconditions are still of limited use.

Notably, these two EurAsEC member states have no explicit political or other barriers to integration of capital markets. This warrants synchronisation of their regulatory systems and infrastructure, which will allow them to quickly and efficiently organise, for instance, trading in Kazakhstani securities and depository receipts on Russian stock exchanges; to secure reliable communication between the holder, the issuer and the registrar by electronic document management systems; and to enable the disclosure of information on these financial instruments at a single EurAsEC centre, irrespective of location, in both Russian and English.

The survey of stock market participants reveals that potential issuers and professional players currently show little interest in the integration of the stock markets of Russia and Kazakhstan and prefer international markets. Thus, competition with other financial centres necessitates significant efforts to improve the attractiveness of regional financial solutions and instruments.

To this end, the establishment of a common Eurasian financial centre with infrastructure elements located across EurAsEC countries and form a single exchange, clearing and settlement system should be the ultimate goal. Existing economic or technical advantages mean that most of these elements will be concentrated in Russia, however, the EurAsEC members (primarily Kazakhstan) will have a role to play in the capital and physical infrastructure of the main institutions of this supranational financial centre.

As part of this effort, the EDB can position itself as a unique institution which can not only catalyse the investment process but also serve as an infrastructure bridge between the capital markets of Russia and Kazakhstan and, potentially, other EurAsEC countries. It is of particular importance because, according to our survey, the level of mutual Russian and Kazakhstani capital market penetration does not match the actual potential for bilateral cooperation.

Decision-making on capital market integration issues could be greatly accelerated if, following the inception of the Customs Union of Russia, Kazakhstan and Belarus (which seemed unrealistic just a short time ago), the issue of a common currency is once again placed on the political agenda. The adoption of a common currency would spur diverse synergetic effects in the economies of the member countries. In the short to medium term a broader use of national currencies in mutual trade could have positive effect on the integration of capital markets.

To date, the most serious concerns are centred around the fact that, though the Russian economy faces the challenges of post-crisis rehabilitation, no strategic documents or policies have yet been formulated on the development of the Russian financial market as the backbone of an integrated EurAsEC capital market. This is a dangerous oversight as competition between the developing markets is tough.

We hope that this publication will contribute to the policy-making and formulation of measures for the development of the capital markets in Russia and Kazakhstan. The main conclusions of the study are presented below.

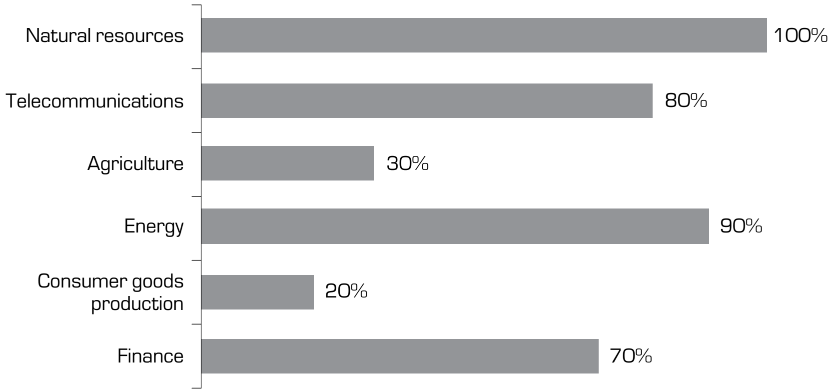
Opportunities for mutual penetration in the Russian and Kazakhstani stock markets

- Extensive economic ties between Russia and Kazakhstan open opportunities for closer interaction between the national stock markets. The most important issue here is perfection, harmonisation and unification of the legal framework for the issuance of, and trading in securities and the activities of professional stock market players.
- Some regulatory provisions and mechanisms for trading and placement of foreign securities on Russian and Kazakhstani markets are already in place.

- Free trading in Russian and Kazakhstani securities (registration of transactions) in each other's territories, including organised markets, is technically impossible unless registrar licences become mutually recognised.
- In the case of Russian and Kazakh depository receipts (RDR and KDR), the legislation was passed ahead of market needs, as not a single issuance has been registered to date.
- Integration of the securities markets of two states is still at an initial stage. Both Russian and Kazakhstani regulations provide for foreign securities turnover on the national organised markets, but currently Russian regulations contain more restrictions compared to those of Kazakhstan.

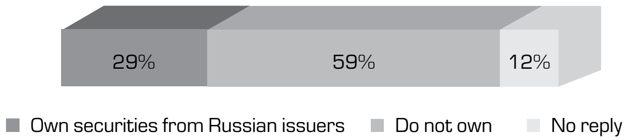
Needs and preferences in respect of the mutual penetration of stock markets: survey results

- Kazakhstani players are interested in Russian financial market as a source of financial resources. By contrast, Russian businesses view Kazakhstani capital market as a springboard to Kazakhstan's natural resources. As one would therefore expect, most Kazakhstani organisations are keen to have their securities traded on the Russian market, whereas Russian companies are not interested in the Kazakhstani market in this way.
- Natural resources, financial institutions, energy, and telecommunications are the priority sectors for Kazakhstani professional stock market players. Russian players only indicated interest in the natural resources sector and in Kazakhstani financial institutions.



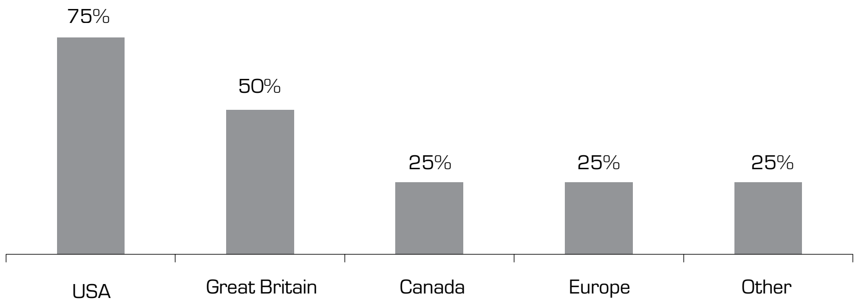
Priority sectors for Kazakhstani professional players

- Most of the Kazakhstani organisations that already hold Russian securities intend new purchases in the next six months. Over 30% of respondents intend to buy Russian securities for the first time. Some respondents pointed out that they buy Russian securities in the form of GDR or ADR internationally rather than from the Russian stock exchanges.

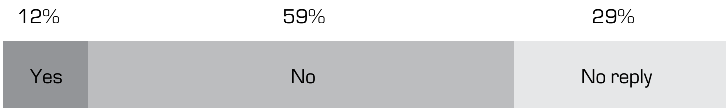


Kazakhstani ownership of Russian securities

Russian ownership of Kazakhstani securities



Kazakhstani ownership of other countries' securities



Interest in having securities listed in Russia

- At present, Kazakhstani issuers are not interested in the Russian market and most of them have listed their securities on the LSE. Direct trading in foreign securities on Russian stock exchanges is limited by excessive legal restrictions.
- As the financial crisis persists and the capital markets of Russia and Kazakhstan still have insufficient integration with the global market, the Russian and Kazakh legal provisions for the issuance of RDR and KDR on foreign securities in the national stock exchanges are still of limited use.
- Financial resources controlled by Russian private pension funds or management companies can be viewed as a potential source of Russian portfolio investments in Kazakhstani securities. However, to

use these opportunities provided by Russian law, index funds holding Kazakhstani securities must be created. This is unlikely to happen in the near future, at least until the Kazakhstani capital market recovers from the global crisis and/or Kazakhstani securities are traded on the Russian market.

- Kazakhstani pension funds are active players on the financial markets of the republic and elsewhere. However, they should not be relied on as a means of significant investments abroad, particularly not in Russia. At present they are redirecting their investment strategy towards increasing holdings of Kazakh government securities and reducing investments in foreign securities.

Integration of Russian and Kazakhstani stock exchanges

- Our survey covered Russia's main stock exchanges (RTS and MICEX) and their Kazakh counterpart – KASE. RTS ranks first of the two in terms of investments in other country. To date, only RTS has a subsidiary in Kazakhstan (Commodity Stock Exchange ETS) and holds Kazakhstani securities.
- Russian stock exchanges are showing interest in cooperation with Kazakh partners and wish to add Kazakh instruments to their trading lists.
- Although the main responsibility for simplifying interaction between organised market players from two countries lies with stock exchanges themselves, the legislation also has an important role to play in this process. For example, both stock exchanges and professional capital market players need an adequate mechanism of nominal holding for foreign investors that should fit in with the laws of two states, and a developed clearing system, including centralised functions.
- Another important element of technical integration is the development and introduction of a common electronic document management technology, which would allow information exchange between the stock exchanges and the traders to be standardised and accelerated.
- In the short term, the main focus should be on the integration of stock exchanges of Russia and Kazakhstan as the hosts of the most developed markets in EurAsEC. A positive example of integration on the commodity market is the establishment in late 2008 of the Eurasian Trade System (ETS) commodity exchange by RFCA (40% of the charter capital) and RTS (60%).
- We should also highlight the project to create the Eurasian Stock Exchange of Agricultural Produce, Raw Materials and Foodstuffs that is

being developed on the initiative of the EurAsEC Integration Committee with the participation of Russian and Kazakh partners. This basically competes with the above ETS project. The new exchange will be based on the Belarusian Universal Commodity Exchange and is expected to start in 2011. If this project becomes a success, it would be desirable for its members to find mutually acceptable mechanisms for its integration with the ETS – perhaps envolving already operational trading floor in Almaty.

- During the past decade a great deal of organisational work has been carried out in both countries, however we cannot so far say that an adequate level of integration has been achieved, nor can we say that we are nearing a common stock exchange space.

Introduction

At the current stage of the economic development of post-Soviet countries their capital markets generally show very modest achievements, with only Russian and, to a lesser extent, Ukrainian and Kazakhstani markets approaching a medium level of development. With the persistent fragmentation of the economic space of the CIS and EurAsEC, less than a year ago only bilateral interaction between capital markets was deemed feasible. However, the events that took place during this short time span, particularly, the realignment of political forces in Ukraine and the inception of the Customs Union of Russia, Kazakhstan and Belarus, have created potential for advancing closer interaction of capital markets. This potential could be amplified further if Russia and Kazakhstan attempt to coordinate their initiatives to create internationally recognised financial centres in both countries.

The need for a coordinated development approach is driven by the challenges two countries have in common, combined with increasing activity in each other's stock markets by their professional players and infrastructure organisations, including the stock exchanges themselves. Enhancing the interaction between Russian and Kazakhstani capital markets is pivotal in the light of the prospective launch of Russia-Kazakhstan-Belarus Common Economic Space (CES). This interaction could provide a basis for regional economic integration in general and promote the development of a transborder financial infrastructure in particular. Integration of financial markets will enable a more efficient application of savings and attract additional investments. Issuers will be able to reduce their borrowing costs and investors will have the opportunities to diversify their investment portfolios, resulting in lower investment risks. The funds raised on the integrated capital markets of Russia and Kazakhstan (and, prospectively, other CES countries) can be used to finance transborder infrastructure development in various sectors.

Therefore, the assessment of the prospects for integration of the capital markets of Russia and Kazakhstan is an important stage for coordinated economic development of these countries and other EurAsEC members alike. In the present conditions, EurAsEC needs a comprehensive financial policy which must be closely related to the real sector of the economy. The assessment includes, inter alia, a comparative analysis of the legal framework and regulations applicable to the capital markets of both countries in order to identify critical differences and develop common approaches to common problems. Following this logic, close attention must be paid to the development of consolidated financial market infrastructure, including interconnected systems of exchange trading, settlement and clearing, in order to create the technological premises for free movement of capital.

More precise tuning of financial market regulation and infrastructure (in legal and institutional terms) will require identification of the needs and preferences of market players from both countries, and with due regard for the fact that these needs and preferences reflect the current regulatory environment and infrastructure. Overcoming the existing barriers will require an analysis at the supranational level. This report is the EDB's contribution to study and systematise the main problems impeding the integration of the capital markets of Russia and Kazakhstan.

Current status: mutual penetration of stock markets and infrastructure

- At present, Russia and Kazakhstan have the most developed stock markets in the post-Soviet space.
- However, the weak legal framework renders them prone to crises and impedes mutual penetration.
- Integration of the securities markets of EurAsEC and CIS countries is still at an initial stage.

The development and main features of the stock markets of Russia and Kazakhstan

The development of the stock markets

In both Russia and Kazakhstan, the stock markets evolved in parallel with the market economy. The foundations were laid in the 1990s, when privatisation gave rise to the first joint-stock companies, broker firms and stock exchanges. Russia implemented a mass privatisation programme, and initially privatisation coupon exchange occurred outside the organised market. In Kazakhstan stock market development and privatisation of state assets proceeded simultaneously – through public placements on the young stock exchange.

This resulted in the state-initiated placements being largely sold to strategic investors, rather than the public at large.

Almost simultaneously both countries adopted laws to regulate the stock market and created the necessary infrastructure, including stock exchanges, depositories and clearing agencies. Various factors, such as institution building, adoption of new laws and socioeconomic reforms eventually determined the specific features of the national markets (Golovnin et al., 2010).

Whereas in the 1990s the stock market functioned essentially as a mechanism for the redistribution of property, from the early 2000s they worked to attract investments in the economy. The first foreign securities appeared on Russian (Tararuyev, 2010) and Kazakhstani (Dontsov, 2003) stock markets, and nongovernment issuers were becoming increasingly active. However, the real investment potential of the stock markets still fell short of the countries' need for financial resources.

Between 2005 and 2007 there was an upsurge in stock market activity in both countries: the average annual growth of the Russian Stock Exchange (RTS) was 50%, whilst that of Kazakhstani Stock Exchange (KASE) exceeded 150%. Russian and Kazakhstani markets became leaders in the post-Soviet space in most parameters. For example, at the end of 2007 capitalisation of the Russian and Kazakhstani markets had reached 99.8% and 40.8% of GDP, respectively. Yet in many other qualitative characteristics (market liquidity, dividend yield, number of instruments traded) they lagged behind the leading developing markets, let alone the developed markets.

The financial crisis of 2008 seriously affected the dynamics and structure of the Russian and Kazakhstani securities markets. A dramatic capital outflow, pressing macroeconomic problems (inflation, slowdown in industrial growth, huge external private sector debt, etc.) led to a

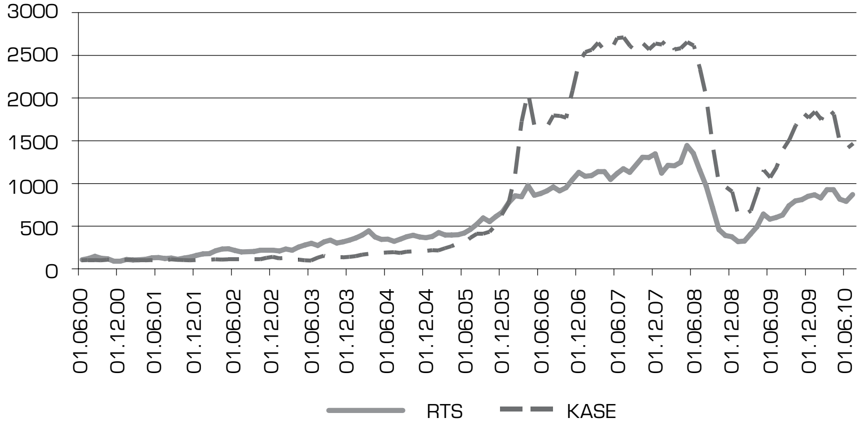


Figure 8.1. Stock market indices in Russia and Kazakhstan (2000–2010)

Note: June 2000 = 100%

Sources: RTS and KASE

protracted decline of the overcapitalised markets at the end of 2008 (see Figure 8.1). The level of non-residents' transactions and private investors also shrank, and other categories of investors, such as investment funds, low-keyed, too.

The decline in market capitalisation in 2008 was especially sharp in Russia and Kazakhstan, as these countries had the most open economies in the CIS. According to the CIS Executive Committee, this index dropped by more than 70% in Russia and more than 40% in Kazakhstan (CIS Executive Committee, 2009). Today the markets look more optimistic. In late June 2010 capitalisation on KASE was $52.6 billion[1]. In dynamics, this represents a 19% increase over 2009, yet it falls some 30% short of the 2008 capitalisation level. In Russia, as at September 30, 2010, total market capitalisation had reached $817 billion – an annual growth of 21.5%, but merely 35.6% of the 2008 level[2].

The Russian and Kazakhstani stock markets are the unquestionable leaders in the CIS in absolute figures. Belarus has a market of government securities, but there is no notable progress in the corporate market development. In Central Asia, organised securities markets are very weak, although they have demonstrated positive dynamics in recent years.

Currently both the Russian and Kazakhstani stock markets lack a strong investor base. Many regulatory issues still need to be worked out, and market players are less protected than in developed countries. The derivatives market, which provides protection against risks, is also poorly developed. In its assessment of the stock market laws of its 29 member states the EBRD classifies Russia and Kazakhstan as medium compliance countries by International Organisation of Securities Commissions (IOSCO) standards (EBRD, 2008).

The Russian stock market is characterised by considerable commercial bank activity. Only limited quantities of shares from Russian issuers can be found in free circulation. This situation can be explained by high concentration of shares in the hands of a limited number of holders. Individual investors have no direct access to the market, because shares are being bought up in packages by wholesale brokers and commercial banks. Institutional investors (unit and incorporated investment funds, pension funds, insurance companies) are not sufficiently represented among the professionals. On the whole, the Russian market is still largely speculative (Sergeyev, 2007).

In Kazakhstan, banks are also active stock market players. They issue shares, bonds, bills of exchange, certificates of deposit and other instruments, act as

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[1] *http://www.investfunds.kz/indicators/.*
[2] *http://stocks.investfunds.ru/indicators/capitalization/.*

investors and carry out agency transactions in securities (Dontsov, 2003). Companies working in the retail sector and investment services make no secret of the fact that their goal is merely to raise financial resources in Kazakhstan with a view to invest them abroad. This position bears no promise of benefit for the Kazakh economy, but nevertheless creates a competitive environment and fuels market activity (Biznes & Vlast, 2008). Pension funds had been the largest group of domestic investors prior to the crisis, but, due to their investment rules, they have currently reduced their presence on the shares and bonds market. Compared to Russia, the Kazakhstani stock market is characterised by low liquidity of the secondary market which is attributable mainly to a lack of traded instruments and poor development of the derivatives and shares markets. Many Kazakhstani issuers are still reluctant to disclose their financial information or share control over their business with external shareholders (Karagusova, 2008). Generally, these problems can be found in all CIS stock markets, and this, along with the legal barriers, impedes the integration process in the region.

Interaction between Russia and Kazakhstan in investments and finance

Economic cooperation between Russia and Kazakhstan is traditionally intensive. According to data from the System of Indicators of Eurasian Integration (EDB, 2009), the country pair Russia-Kazakhstan shows the highest level of integration in terms of mutual trade. The EurAsEC region, which both countries belong to, also records positive integration dynamics. Whereas in 2000 Russian investments in Kazakhstan accounted for as little as 0.4% of the total investments in EurAsEC countries, by 2008 this figure had increased to 7.7% (Heifetz, 2009). However, the main target for Russian investments is Belarus. Kazakhstan, on the contrary, is the main investor in Russia within the EurAsEC grouping. In 2000 Russia received 49% of all investments in EurAsEC countries, and by 2008 this

Table 8.1. Accumulated mutual investments by Russia and EurAsEC countries (early 2008, $ million)

Source: Heifetz, 2009

	Russian investments in EurAsEC countries			EurAsEC countries investments in Russia		
	2000	2008		2000	2008	
	All	All	Direct and portfolio investments	All	All	Direct and portfolio investments
Belarus	490.2	771.2	661.9	2.5	103.5	32.7
Kazakhstan	2.2	99.7	30.2	5.7	894.8	228
Kyrgyzstan	0	20.6	0.1	0.1	70.5	532
Tajikistan	0	61.7	1.2	0	25.9	0
Uzbekistan	0.4	333.9	250.7	3.5	7	5.2
Total EurAsEC	492.8	1287.1	944.1	11.6	1101.7	271.1
Total CIS	555.6	2521.4	1921.3	19.3	1502.6	562.8

figure had increased to 81%. Thus, the interaction between Russia and Kazakhstan demonstrates an upward trend (see Table 8.1).

To date, the Russian investments in neighbouring countries (particularly, EurAsEC members) target exclusively natural resources and energy (Heifetz, 2009). In Kazakhstan, the main recipient of Russian capital is the fuel and energy complex. According to a number of open sources, many large stock market players in Russia, including RTS, MICEX, Sberbank, Depository and Clearing Company, and Rosbank, show sustained (albeit narrow) interest in cooperation with Kazakhstani securities market institutions.

Financial institutions from CIS countries are strengthening their presence on each other's markets (Golovnin, 2008). Russian and Kazakhstani banks are especially active in foreign expansion; in particular: VTB, Sberbank and Alfa Bank of Russia and BTA Bank, Kazkommertsbank and Halyk Bank of Kazakhstan. Russian investment companies are gradually entering the emerging CIS stock markets, preferring the relatively advanced markets of Ukraine and Kazakhstan. Thus, KIT Finance and Renaissance Capital established their presence in Kazakhstan, and Troika Dialog joined them recently. In addition, two management companies (subsidiaries of Russian companies), KIT Fortis Investment Management and Avangard Capital, are now operating in Kazakhstan. Members of Kazakh banking holding companies are also present in the Russian stock market. These are typically small, except for East Kommerts investment group, which at the end of 2007 ranked 7th among Russian investment companies in terms of securities transactions.

Unlike banks and investment companies, organisations representing stock market infrastructure (stock exchanges, depositories, clearing agents) do not so far have a significant presence in other countries' markets. They interact mainly by entering into memoranda of understanding. There are three examples worth noting: KASE's shareholding in the Kyrgyz Stock Exchange; a joint project between RTS and Ukrainian investment companies to establish a new Ukrainian Stock Exchange; and a joint project between KASE and RTS to launch the Eurasian Trade System in Almaty.

The financial markets of Russia and Kazakhstan principally work as mechanisms for raising speculative capital which leaves the country fast during a crisis.

As mentioned above, after the crisis of 2008-2009 the stock markets of Russia and Kazakhstan faced similar problems: a decline in liquidity, the withdrawal of foreign investors, and a drop in stock indices. Under these conditions the importance of portfolio investments grew up in both countries. According to statistics (see Table 8.2), Kazakhstan ranks 26th in terms of portfolio investments in Russia, whilst Russia ranks 11th in terms of portfolio investments in Kazakhstan.

Investments in Russia	Volume	%	Ranking	Investments in Kazakhstan	Volume	%	Ranking
Luxemburg	5609	23	1	USA	18526	59	1
Ireland	5024	20	2	UK	1883	6	2
USA	3225	13	3	Japan	1870	6	3
Netherlands	2483	10	4	Germany	1693	5	4
Virgin Islands	1889	8	5	France	1625	5	5
Cyprus	1877	8	6	Netherlands	1553	5	6
UK	1317	5	7	Italy	766	2	7
Germany	889	4	8	International organisations	727	2	8
Australia	780	3	9	Australia	584	2	9
International organisations	505	2	10	Belgium	429	1	10
Kazakhstan	17	0	26	Russia	428	1	11

Table 8.2.
Portfolio investments (2008, $ million)
Source: CPIS, IMF

	From Russia to the CIS			From the CIS to Russia		
	2000	2005	2008	2000	2005	2008
Total CIS	118	162	1164	7	71	151
Azerbaijan	0	0	0	0	41	0
Armenia	0	126	437	0	4	2
Belarus	77	8	667	0	11	16
Georgia	0	0	0	0	0	0
Kazakhstan	0	1	51	0	9	104
Kyrgyzstan	0	0	0	0	0	21
Moldova	31	0	0	1	0	0
Tajikistan	0	0	0	0	0	0
Turkmenistan	0	0	0	0	0	0
Uzbekistan	0	0	0	0	1	1
Ukraine	10	27	9	6	5	7

Table 8.3.
Russian portfolio and direct investments ($ million)
Source: CIS Statistics Committee

Official statistics indicates that mutual investments by two countries remain at a minimum level. Russian direct and portfolio investments in Kazakhstan in 2008 amounted to as little as 1.4% of all foreign investments (see Table 8.3).

Interaction between the stock markets in the CIS in the pre-crisis period was studied by Libman (2010). His calculations of stock indices correlation showed that this interaction is especially intense between the Russian and Kazakhstani markets. The correlation index in the period from July 2000 to May 2008 was 0.96. This can be explained by the high degree of convergence of two economies and the way these are regarded by foreign investors, who approach both in a similar fashion. According to recent data, during the crisis (from June 2008 to December 2009) correlation increased to 0.98 – a clear sign of the strong ties between the Russian and Kazakh economies. At the beginning of 2010 the correlation of RTS and KASE indices dropped back to 0.74.

The absence of integration in Asian markets can be explained principally by low liquidity and underdeveloped financial systems, which make investors turn their attention to other financial centres.

In an attempt to identify the reasons for low financial integration observed despite intensive trade, interconnected infrastructure and close historic and cultural links, we might turn to the example of Asian countries. Traditionally, mutual trade is high, but their stock markets practically do not interact at all. The International Bank for Economic Cooperation conducted a study of integration of stock markets in Asia (Garcia-Herrero et al., 2008) and the authors put forward four hypotheses on the factors which determine the degree of interaction: 1) geographic direction of investments; 2) trade; 3) profitability; and 4) liquidity. The conclusion was that the absence of integration in Asian markets can be explained principally by low liquidity and underdeveloped financial systems, which cause investors to turn their attention to other financial centres.

Similarly, a lack of liquid instruments for institutional investors and long-term capital within the country and, as a result, outflow of large issuers towards foreign stock exchanges impede the development of the stock markets in Russia and Kazakhstan and the interaction between them.

Comparative analysis of legal frameworks and infrastructure

The extensive economic ties between Russia and Kazakhstan open opportunities for closer interaction between the national stock markets. The most important issue in this context is the enhancement, harmonisation and unification of the legal framework for the issuance of and trading in securities and the operation of professional stock market players. The current status of the legal framework deserves close attention; in *Table 8.4* we compare some critical provisions of securities market regulation in two countries.

Basic legal framework

All professional activities on the securities market are subject to licences issued by the authorised body in charge of the securities market: the Federal Financial Markets Service (FFMS) in Russia and the Agency for Regulation and Supervision of the Financial Markets and Financial Organisations (FSA) in Kazakhstan. The main functions of these bodies are: to create incentives

	Russia	Kazakhstan
Main law	The Law *On the Securities Market* (RF, 1996) provides for the following activities: 1) brokerage; 2) dealer services; 3) securities management; 4) clearing; 5) depository services; 6) registrar services; and 7) organisation of trade in securities. The federal executive body in charge of the securities market (RF, 2004) is FFMS which controls and supervises financial markets (except insurance, banking and auditing).	The Law *On the Securities Market* (RK, 2003a) provides for the following activities on the securities market: 1) brokerage; 2) dealer services; 3) registrar services; 4) investment portfolio management; 5) pension fund investment management; 6) custodian services; 7) transfer agent services; 8) organisation of trade in securities and other financial instruments; and 9) depository services. State regulation and supervision of the financial market is the responsibility of the Agency for Regulation and Supervision of FSA (RK, 2003b).
Registrars	There is a restriction on registrar services for foreigners. In accordance with the Russian Law *On Joint-Stock Companies,* for joint-stock companies comprising more than 50 shareholders a share register must be kept by a registrar. The same law also provides that for these companies the registrar may act as a tabulation commission at general meetings of shareholders. However, only companies comprising more than 500 shareholders are obliged to employ registrars to do so.	In accordance with the Law *On the Securities Market,* a register system is compulsory for equity securities and must be kept by a registrar.The functions of, and requirements for registrars are all set forth in the Rules of *Keeping a Register System* and are largely identical to those imposed by the Russian register rules.
Depositories	Under Russian law, foreign depositories are not treated as “professional securities market players” and therefore cannot be recognised as depositories or open fiduciary accounts with a Russian depository. Russian depositories can open accounts for non-resident depositories as beneficial owners only, but not as nominal holders (Aksenova, 2007).	Professional securities market players (“nominal holders” under Kazakh law) and foreign depositories and custodians may open fiduciary accounts with the Central Depository of the Republic of Kazakhstan.
Public placement and/or trading in foreign securities	There is a list and a reference book of foreign instruments which the FFMS recognises as securities. Only selected securities may be publicly placed and/or traded in Russia. A precondition for the placement of foreign securities is registration of the respective prospectus with FFMS. Public placement of foreign securities is subject to approval by a stock exchange. Notably, a stock exchange may approve the placement only if the securities are listed on a stock exchange from FFMS’ list (this does not apply to securities issued by international financial organisations).	Nongovernment securities issued under the laws of foreign states and securities of international financial organisations from the official list of the stock exchange may be traded on the organised securities market in Kazakhstan. The list of international financial organisations whose equity securities may be traded on stock exchanges is drawn by stock exchanges themselves and must be approved by the Agency of Regulation and Supervision of the Financial Market and Financial Organisations. Issuers who wish to include their shares or debt securities in the first quality sector must meet very stringent requirements.

Issuance of national depository receipts representing foreign securities	Russian law imposes certain requirements for RDR issuers. RDR may be issued by a depository which meets FFMS requirements as to equity capital size and has a track record of at least three years. At present, the list of permitted issuers includes 64 organisations, mainly central depositories from foreign states, including the Central Depository of the Republic of Kazakhstan. If the issuer of the underlying securities does not assume any obligations to RDR holders, such RDR may be issued only if the securities are listed on a foreign stock exchange from FFMS' list. Requirements for RDR registers are set forth in the rules of keeping registers of RDR holders. In accordance with these rules, a register of RDR holders may be kept either by the issuer (depository), irrespective of the number of holders, or a registrar. It should be noted that the law anticipated market needs, as not a single RDR issuance has been registered to date.	Under Kazakh law: 1) a KDR issuer must hold a licence for custodian business; 2) the shares of a KDR issuer must be on the official highest quality list of the stock exchange; 3) a KDR issuer must have operational risk management and corporate governance systems. The issuer of the underlying asset may not be registered in an offshore territory or affiliated with an organisation registered in an offshore territory, and must have a rating not lower than 'BB-' from Standard & Poor's or Fitch Rating Ltd. Underlying securities issued by residents of Kazakhstan must be on the official first quality list (the "Shares" sector) of a stock exchange operating in Kazakhstan. Registration and confirmation of title to KDR is the responsibility of the Central Depository of the Republic of Kazakhstan. No KDR issuances have been registered to date.
Placement of national securities abroad	In accordance with the Russian Law *On the Securities Market,* Russian issuers may place their securities outside Russia by various methods, including placement of securities of foreign issuers who confirm their rights to the equity securities of Russian issuers under foreign law, however, subject to FFMS approval and other conditions. There are a number of requirements for the number of shares of Russian issuers which are to be placed and/or traded outside Russia.	Residents of Kazakhstan may place their shares abroad if they are on the official first quality list (the "Shares" sector) of a stock exchange operating in Kazakhstan. In addition, Kazakhstani shares may be placed abroad if they are listed in the "Non-listed Securities" sector of a stock exchange operating in Kazakhstan.

Table 8.4. Stock market regulation in Russia and Kazakhstan

for the improvement of corporate governance of financial organisations; to monitor the financial market and financial organisations in order to secure the stability of the financial system; to place an emphasis on financial market segments which are exposed to higher risks in order to maintain financial stability; to introduce modern technology; and to ensure that end users have access to all the information on the activities and services of financial organisations.

Stock market registration system

The stock market registration system consists of two groups of professional market players: registrars and depositories.

In Russia, as at July 1, 2010, only 48 professional market players held licences for registrar services. Their number shrank rapidly over recent years after the FFMS introduced the requirement that each registrar must service at least 50 issuers comprising at least 500 holders; a requirement that impedes competition. Many organisations find it difficult to overcome this administrative barrier, as there are very few initial placements and the number of shareholders in joint-stock companies tends to shrink as a result of equity consolidation. Furthermore, smaller companies are permitted to perform registrar functions by themselves. At present the FFMS does not have any real tools by which to interfere with registrar and counting commission functions in companies. Notably, it is the procedure for convening meetings and especially the absence of a clear definition of the duties of a counting commission in the law that causes many corporate conflicts.

In Kazakhstan, as at July 1, 2010, there were 11 licensed registrars that are entitled to engage in this business irrespective of the number of issuers they service. They interact with three licensed transfer agents. A register system is compulsory for equity securities and it must be maintained by a registrar; this presents an advantage over the Russian law that allows issuers with less than 50 holders to keep registers by themselves.

In Kazakhstan, a register system is compulsory for equity securities and such a system must be maintained by a registrar; this represents an advantage over Russian law which allows issuers with less than 50 holders to keep registers by themselves.

As at July 1, 2010, 738 market players held licences for depository services in Russia. Most of them use these licences for providing their clients with access to settlement and depository systems and registers, thus acting as client (custodian) depositories. Consequently, Russian professional market players and investors use the services of such depositories to dispose of shares and units in unit investment funds without directly accessing the registrar, i.e. by book-entry settlement using custodian accounts and representing the holders' interests in the register or other depository as nominal holders.

Some serious problems with regulation of depository business in Russia are associated with gaps in the Federal Law *On the Securities Market*. The situation is complicated even further by the Central Bank's wide interpretation of its authority to impose special requirements for registration of title to government securities and to issue instructions to this end without consulting with the FFMS or the professional community. As a result, depositories are forced to maintain special register systems and charts of accounts which do not comply with FFMS regulations and existing business procedures (formulated in self-regulating organisations' standard documents).

The existence of different approaches to regulation of book-entry settlement should be excluded. Imperfect regulation is a major weakness of the Russian stock market's registration infrastructure. The regulations change too often and are complicated by the established trading and registration systems.

Imperfect regulation is a major weakness of the Russian stock market's registration infrastructure. This regulation changes too often and is complicated by the traditional organisation of the trading and registration systems.

The problem with foreign nominal holders is associated with the threat of liquidity loss, i.e. shift of activity from Russian stock exchanges to foreign ones.

According to FFMS requirements, the registration of title to foreign securities intended for pubic placement (trading) in Russia must be registered with a depository whose business meets the general requirements applicable to depositories. In addition, the FFMS imposes some special requirements on this type of depository:

1) it must have a track record of at least one year;

2) it must provide services associated with receiving yield from foreign securities or other payments to which the holder is entitled, to all persons (depositors) whose title to foreign securities it has registered.

Finally, the depository must maintain an account for each of those persons acting on behalf of other persons with a foreign registrar from FFMS' list.

These strict requirements for depositories were dictated by the problem of foreign nominal holders. It is associated with the threat of liquidity outflow, i.e. a shift of activity from Russian stock exchanges to foreign exchanges (Golovnin et al., 2010). A reluctance to operate on domestic stock markets can lead to the loss of potential market turnover in Russia and other CIS countries.

Kazakhstan has a two-tier depository system. The first tier consists of the Central Depository. The second tier is comprised of the first category brokers and dealers (who are authorised to maintain clients' accounts as nominal holders (and register transactions in securities)) and banks providing custodian services. As at July 1, 2010, there were 11 custodian banks and 81 licensed brokers and dealers. Notably, the Central Depository started to establish correspondent relations with depositories from other CIS countries earlier than its Russian counterparts (Golovnin et al., 2010).

To sum up, Russian Law *On the Securities Market* does not recognise professional market player licences issued under foreign laws. Russian registrars cannot open fiduciary accounts for non-residents, including depositories and other nominal holders, and can only open these accounts for depositories licensed by FFMS. As a result, depositories and other nominal holders cannot establish correspondent relations, which in turn preclude settlement under transactions in securities (supply of securities or money). Kazakh law already contains all the necessary provisions. Fiduciary accounts can be opened with the Central Depository of the Republic of Kazakhstan not only by nominal holders that qualify under Kazakh law, but also by foreign depositories and custodians.

Placement of foreign securities

Legal restrictions on mutual access to stock markets and issuance and placement of securities create barriers to mutual capital flows.

Our comparison of two countries' legal frameworks shows that certain legal preconditions for mutual capital flows in the form of financial instruments are already there. However, the existing differences in Russian and Kazakh laws create barriers to these flows, specifically the legal restrictions on mutual access to stock markets and issuance and placement of securities.

At present, foreign securities can be placed in Russia and Kazakhstan by two methods:

- public placement and/or trading in foreign securities;
- issuance of national depository receipts representing foreign securities.

Importantly, a permit to trade in foreign securities on Russian and Kazakhstani stock markets can be issued by a stock exchange, subject to approval by the authorised body. In Russia, in contrast to public trading, public placement of foreign securities can be permitted only by the FFMS. In any event, public placement is initiated and performed by stock exchanges, and they are responsible for the introduction of foreign securities on the market. However, Russian stock exchanges can handle only securities that are listed on a stock exchange from FFMS' list (with the exception of securities issued by international financial organisations); furthermore, the stock exchange must be member of:

- the World Federation of Stock Exchanges;
- the Federation of Euro-Asian Stock Exchanges; or
- the CIS International Association of Stock Exchanges.

The stock exchange in question must be incorporated in one of the OECD/FATF/MONEYVAL countries. This can also be a state with which the FFMS has an agreement on interaction[3]. If a stock exchange withholds its permit for public placement, a permit can instead be issued by the FFMS, provided that the securities meet certain liquidity and investment risk requirements.

The Russian Law *On the Securities Market* is different in that it regulates not only public placement of, and trading in foreign securities, but also the private

[3] *FFMS' Order no. 10–29 dated April 27, 2010. On Approval of Criteria and Procedure for Inclusion of Foreign Stock Exchanges Whose Listing Is Compulsory for Issuing Permits by Russian Stock Exchanges for Trading in Foreign Securities without a Permit from the Federal Executive Body in Charge of the Securities Market for Public Placement and/or Trading in Such Securities in the Russian Federation. Vestnik FSFR. 2010. no. 7*

placement of these on the Russian stock market. Even if a foreign issuer does not intend to make an initial public offering in Russia and offers its securities to a small number of chosen investors, it must obtain a permit from the FFMS and have the prospectus registered; furthermore, it must furnish the FFMS with a notice on completion of placement.

One of the major problems which impedes introduction of foreign securities to the Russian market is disclosure of information on securities and issuers.

At present, Russian regulations are more restrictive in respect of trading in foreign securities compared with Kazakhstani regulations.

One of the major problems that impede introduction of foreign securities to the Russian market is information disclosure. The securities market is essentially a market of information, and its competitiveness directly depends on the speed of disclosure of information on traded instruments and respective issuers. The law requires Russian stock exchanges where foreign securities are traded to ensure the disclosure of this information. FFMS experts believe that the stock exchanges can cope with this task by themselves (Medvedeva, Filimoshin, 2010). To date, however, one cannot say that full disclosure of information on corporate events is being achieved.

Under Kazakh law, non-residents cannot issue shares. Placement of non-residents' securities issued under Kazakh law or in other jurisdictions, including Russia, is subject to licensing.

Issuance of securities abroad

This section poses the biggest number of impediments to the integration of the stock market legal framework and legislation in both Russia and Kazakhstan. Under Kazakh law, residents are permitted to issue securities abroad and place them with non-residents only if their previously issued equity securities are listed on a stock exchange in Kazakhstan. In addition, placement of securities with non-residents must be registered as currency transactions related to foreign investments by residents.

So far, no issuances or public placements of foreign securities have taken place on the Russian market, but Russian and Kazakh laws provide for these transactions. At present, the Russian regulations are more restrictive in respect of trading in foreign securities than the Kazakhstani regulations.

International treaties and their role in the development of stock markets

Russia and Kazakhstan are both members of various integration groups. The most efficient vehicle to address the issues of financial markets integration could be the EurAsEC. In 2004 its members entered into an agreement on cooperation in the banking sector (EurAsEC, 2004), which provides, inter alia, for the creation of an interstate securities market.

The parties to this document undertook to adopt measures to:

1) harmonise laws regulating:

- the issuance of securities;
- the placement of, and trading in residents' securities in other countries;
- the placement of, and trading in non-residents' securities;
- the activities of professional securities and mutual investments market players[4];
- disclosure on the securities market;

and set forth:

- the qualification requirements for professional securities and mutual investments market players; and
- the requirements for transactions on the securities market;

2) harmonise the corporate codes of conduct;

3) develop common approaches to control over the securities market.

To date, the financial markets of all EurAsEC countries can be classified as "developing". Thus, according to a World Economic Forum report (WEF, 2009), in 2008 the volume of trade on the stock markets of Russia and Kazakhstan (the group's leading economies) totalled 58.45 and 8.57% of GDP, respectively (compare this to 443.57% in Hong Kong, the absolute leader in this respect). The other EurAsEC countries lag far behind the leaders in banking sector development, which makes the initiative to create a common stock market a long-term plan. Therefore, it seems reasonable to first promote interaction between the Russian and Kazakhstani markets with subsequent inclusion of other EurAsEC members and Ukraine – a country which has extensive economic ties with this community.

It should be admitted at this point that the integration of the securities markets within EurAsEC is still at an initial stage. This statement is best illustrated by the fact that so far the regulatory bodies of Russia and Kazakhstan have no memoranda on understanding or information exchange. Furthermore, KASE is even absent from the abovementioned list of foreign

[4] *Mutual investments market players are investment funds, nongovernment pension funds, management companies, special depositories of investment funds and nongovernment pension funds, and other organisations defined as such in national laws*

stock exchanges whose listing is compulsory for a Russian stock exchange to issue a permit for trading in foreign securities without a permit from the FFMS.

An important step towards an efficient corpus of international documents aimed at furthering capital markets development in Russia, Kazakhstan, Ukraine and Belarus would be to resume the work on the draft Agreement On Adoption of International Standards of Settlement under Transactions in Securities and Derivatives which was halted in 2005 following the refusal by Ukraine's former leadership to participate in the effort to create the Common Economic Space (CES). This draft contained provisions on harmonisation of laws regulating settlement on securities markets; registration and keeping of securities, including the structure and organisation of national registration systems; depository registration; interaction between registration and clearing organisations; and settlement under transactions in securities, including cross-border settlement.

Article 9 of the draft Agreement set forth the following principles of settlement:

"The Parties believe that settlement orders under transactions in securities on the regulated market must be carried out not later than the next business day following receipt of these orders by a depository organisation or a registrar, unless a later date is indicated in the order.

The Parties understand that efficient settlement can only be achieved by a full switch to electronic messaging in recognised international formats and automation of message processing".

We believe that these principles remain relevant, although in 2008 the EurAsEC Integration Committee made an attempt to draft an agreement on creating the conditions for free capital movement on financial markets.

Needs and preferences of Russian and Kazakhstani stock market professional players

- Studying the needs and preferences of market players from both countries in respect of mutual capital market penetration provides a basis for legal and organisational adjustment of the regulatory systems and infrastructure of the financial markets.
- The results of the survey confirm the conclusions of our comparative analysis of laws regulating financial markets.

The preparation for this report was accompanied by a survey of professional market players from Russia and Kazakhstan. The main purpose of the survey was to study the opinions of various organisations concerning their plans and preferences in respect of mutual market access, adequacy of mechanisms available for that, and existing problems and impediments. Apart from general questions the survey also included sections on investments in the other country's securities market, placement, and cooperation between Russian and Kazakhstani stock exchanges. The questions were selected so as to cover a maximum circle of respondents of various specialisations. The results of the survey confirm the conclusions on the prospects for integration of two countries' financial markets.

Survey of professional stock market players from Russia and Kazakhstan

Kazakhstan: categories and specialisation of stock market players

The majority of Kazakhstani respondents who took part in the survey were professional market players (82%).

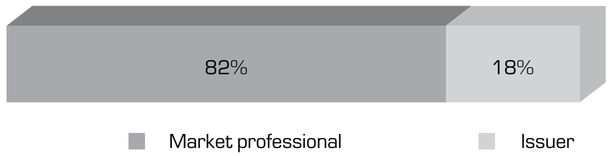


Figure 8.2. Categories of Kazakhstani respondents

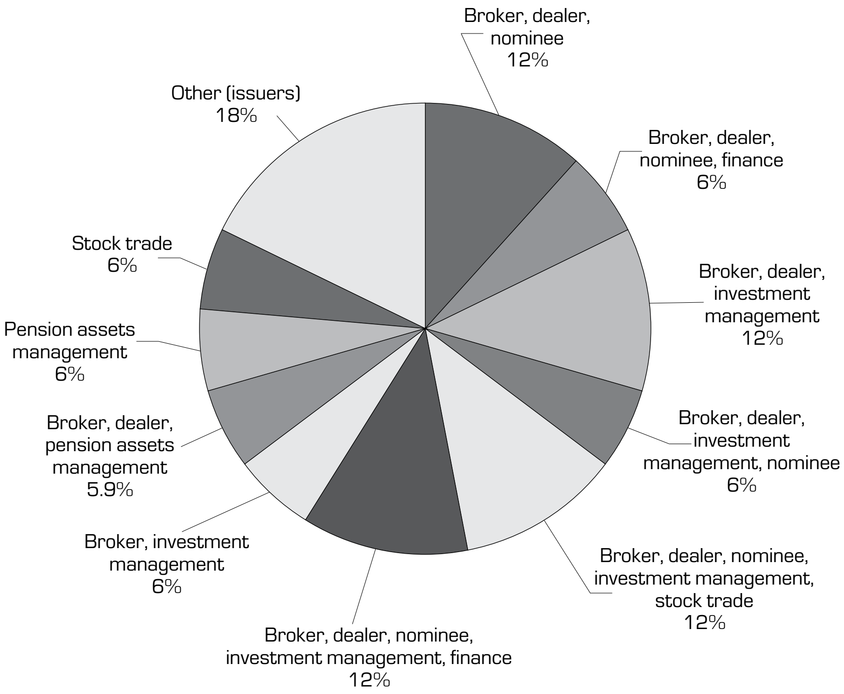


Figure 8.3. Specialisation of Kazakhstani respondents

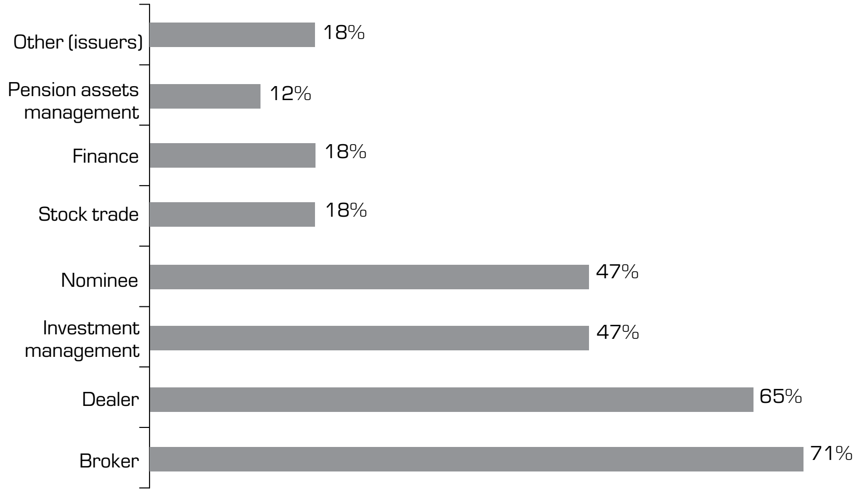


Figure 8.4.
The most common professional activities

The structure of specialisation of Kazakhstani respondents indicates that many of them engage in multiple professional activities provided for by Kazakh law (see Figure 8.3). The most frequent combination (about 17%) is dealer/broker services plus investment portfolio management. The respondents typically engage in numerous activities, which illustrates the flexibility of Kazakh law in this respect. From the point of view of prospective interaction, Russian investors and professional market players will have sufficient choice to select partners with the required functions in Kazakhstan.

The most popular specialisation on the Kazakhstani stock market is broker/dealer business and investment portfolio management (see Figure 8.4). The structure of licences issued by FSA confirms this conclusion (see Table 8.5).

Kazakhstan: investments on the Russian securities market

18% of the respondents have subsidiaries in Russia (see Figure 8.5), and 29% hold Russian securities. Taking into account that 11.8% of the respondents skipped to answer the question on ownership of Russian securities, we can assume that the number might be larger (perhaps about 35%). This indicates that holding foreign instruments is easier than establishing subsidiaries in the neighbouring state. In any case, given the fact that the Russian securities market is well developed and offers higher liquidity compared to the Kazakhstani market, the number of Kazakh holders of Russian securities is likely to be greater.

The data allows us to conclude that Kazakhstani professional market players maintain a presence on the Russian securities market.

Professional players	As at 01.01.07	As at 01.01.08	As at 01.01.09
Brokers and/or dealers	69	87	84
Brokers from the Regional Financial Centre of Almaty	1	19	20
Registrars	17	17	15
Custodians	9	10	11
Pension asset managers	13	11	13
Investment portfolio managers	37	61	66
Self-regulating organisations	2	2	2
Transfer agents	2	3	4
Depositories	1	1	1
Trade organisers	1	1	1
Total	152	212	217

Table 8.5. Number of organisations by professional activities on the Kazakhstani securities market

Source: FSA (2009)

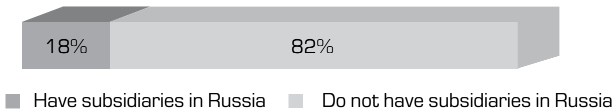


Figure 8.5. Subsidiaries in Russia

Figure 8.6. Kazakhstani respondents holding Russian securities

Most of the organisations that already hold Russian securities intended to buy more in the following six months (the survey was conducted in April–May 2010). Of those who do not hold Russian securities, over 30% intend to buy them. These data are illustrative of relative attractiveness of the Russian market to Kazakhstani professional players.

25% of Kazakhstani respondents hold securities from foreign issuers other that Russian. They commented that these countries have highly developed and diverse stock markets capable of satisfying the needs of both the issuer and the investor. These markets offer high liquidity and are well regulated.

The respondents indicated that they had acquired Russian securities on international stock exchanges in the form of GDR or ADR and not directly from the Russian stock exchanges.

Kazakhstani professional market players are interested in securities issued by the following sectors (see Figure 8.8):

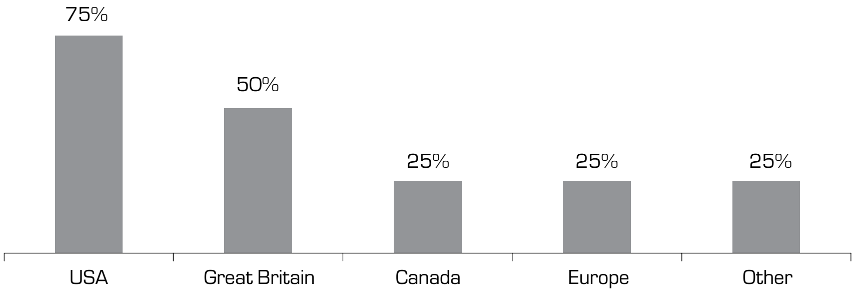


Figure 8.7. Kazakhstani respondents holding securities issued in other jurisdictions

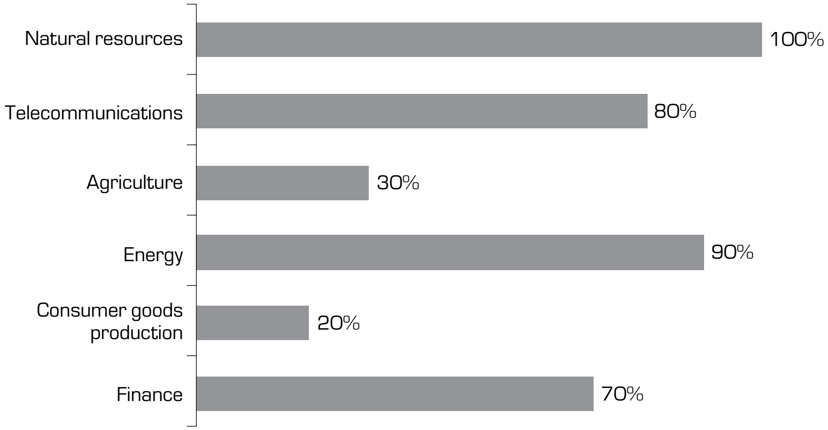


Figure 8.8. Priority sectors for Kazakhstani professional market players

All respondents who answered this question uniformly mentioned natural resources. Many of them also mentioned energy. Telecommunications and finance are also attractive to Kazakhstani players.

As mentioned above, 29% (or, we presume, 35%) of Kazakhstani respondents hold Russian securities. Of this number, over 85% is represented in the registers by depositories, and only 14% is represented directly. Of those represented in registers by nominal holders, equal numbers of respondents preferred the services of depositaries and Russian custodians. One respondent works with a licensed Russian subsidiary of a Western custodian.

Kazakhstan: quality of services of Russian registrars

Over 70% of the respondents indicated their satisfaction with the services of Russian registrars. The respondents were asked to evaluate the quality of services by price, speed, convenience, additional services, and uninterrupted service, on a five-grade scale (5 is the highest mark). The respondents gave high marks to practically all of these components. 80%

are satisfied with the speed of service and 60% are satisfied with prices. Marks for convenience, additional services and uninterrupted service were uniformly high.

Most respondents who were dissatisfied with the quality of services mentioned the high cost of depository services. One respondent (represented in a register by a depository) mentioned inadequate information exchange with the depository.

64% of those who answered the question on the desirability of direct interaction with Russian registrars by electronic document management systems using digital signatures expressed their wish to use this type of system.

Kazakhstan: problems of interaction with Russian financial institutions

Answering the question on problems with interaction with Russian financial institutions, including registrars, most Kazakhstani respondents mentioned the legal restrictions on double nominal holding:

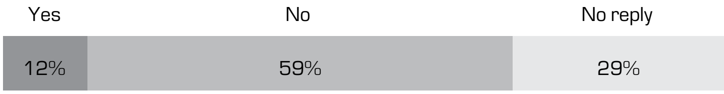
The impossibility of double nominal holding of Russian securities impedes direct investments in Russia by Kazakh investors
The absence of a central depository in Russia
Kazakh law restricts the activities of financial institutions outside Kazakhstan
Legal restrictions on opening accounts with foreign custodian banks, e.g. Russian banks
Kazakh and Russian laws make it impossible to buy Russian securities on MICEX and RTS, since under Russian law securities must be kept by a Russian depository, and under Kazakh law the securities must be registered with a local custodian. At the same time, Kazakhstani custodians and depositories cannot open accounts with Russian depositories. This complicates access to MICEX and RTS
One of the most urgent problems is associated with the nominal holding of Russian securities by foreign brokers and the need for a mechanism of confirmation of title of beneficial owners. This issue has been voiced at the Association of Financiers of Kazakhstan (AFK). If this issue is resolved, Kazakh investors who hold Russian securities will be able to exercise their right to receive issuer information (on shares and depository receipts representing the shares) and other rights attached to securities, and therefore will be able to protect their interests more efficiently
The most serious problem for Kazakhstani players who enter foreign markets as brokers is that Kazakh law restricts the opening of accounts with foreign custodians. This issue has been debated for many years, but to no avail. This issue is now being addressed by the Association of Financiers of Kazakhstan, and working groups are being created to this end from time to time. Unfortunately, the FSA does not seem to be interested to address this problem

Table 8.6. Problems of interaction with Russian financial institutions

Kazakhstan: placement of securities in Russia

As for the prospects for the introduction of Kazakhstani securities to the Russian market, only 12% of the respondents who answered this question are considering the opportunities (see Figure 8.9). 29% of the respondents did not answer this question.

Figure 8.9.
Interest in introducing securities to Russia



As for the issuance of RDR, 88% of the respondents indicated that they have no interest in this instrument, and 12% did not answer this question.

The question on preferred methods of introducing Kazakhstani securities to the Russian stock market was answered as follows: issuance of RDR (12%); direct trading (12%); and creating conditions for the settlement of Russian securities in Euroclear and Clearstream (6%). 70% of the respondents did not answer this question.

The above data allows us to conclude that at present Kazakhstani professional players are not keen to introduce their securities to the Russian market. As a consequence, the problem of selecting professional Russian mediators for the introduction of Kazakhstani securities is not urgent at present. As there have not been any RDR issuances, Kazakhstani market players have difficulty in assessing their prospects for the use of this mechanism. Direct trading on the Russian stock market is naturally restricted by the stringent requirements imposed by Russian law.

Kazakhstan: proposals on cooperation

Kazakhstani respondents suggested the following forms of cooperation:

Joint efforts to harmonise the laws of two countries. Consultations on strategic development, PR and marketing. Exchange of information. Studying each other's IT infrastructure and trading and clearing tools. Cooperation in developing IT solutions for the Kazakhstani derivatives market
Opening Central Depository's accounts with Russian depositories and vice versa, for the purposes of registering and transferring Russian and Kazakhstani securities
Simplifying the procedure of joint listing on Russian and Kazakhstani stock exchanges
Developing legal frameworks for short sale: legal solution plus technical support. IT infrastructure for the organising of trades in Kazakhstan
Cooperation in developing stock exchange infrastructure using advanced technology. Developing the derivatives market
Double listing
Integration of custodian systems in order to eliminate barriers to Kazakh investor's activity in Russia and vice versa (as an alternative to integrating both markets into Euroclear)

Creating conditions under which attracting portfolio investments by Kazakhstani and Russian organisations would be easier and cheaper than it is on Western markets
Cooperation prospects depend on infrastructural interaction between two stock markets

Table 8.7. Possible forms of cooperation

Russia: categories and specialisations of stock market players

In contrast to Kazakhstani respondents, nearly half of all Russian respondents were issuers. All of these issuers are professional stock market players. All responding organisations engage in multiple activities and offer integrated services to their clients.

Russian respondents can be divided into the following groups by type of activity (see Figure 8.10).

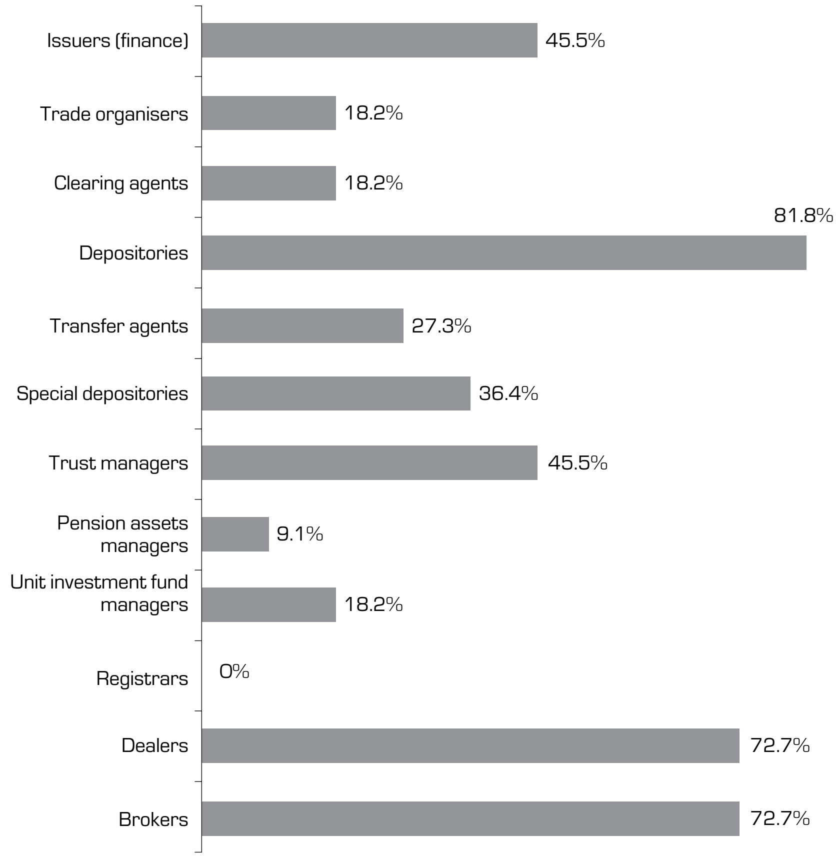


Figure 8.10. Specialisations of Russian respondents

The most popular activity permitted by Russian law is depository services (82%). Other frequently mentioned activities are broker and dealer services (73%) and trust management (45%).

Russia: investments on the Kazakhstani securities market

In contrast to Kazakhstani organisations, Russian respondents maintain a stronger presence in the neighbouring capital market: some of them hold Kazakhstani securities (see Figure 8.11) and, at the same time, have affiliates in Kazakhstan (50%).

Figure 8.11. Russian respondents holding Kazakhstani securities

82% of Russian respondents do not intend to buy Kazakhstani securities in the next six months. Typically, Russian businesses view Kazakhstan as a source of natural resources and are reluctant to invest (or organise investing) in other sectors of the Kazakh economy. However, there is a degree of interest in the Kazakh financial sector. We can conclude that currently Russian professional securities market players do not consider Kazakhstan as a target for placement.

46% of the respondents hold Kazakhstani securities. Of this figure, over 36% is represented in registers by the Central Depository and 18% are represented directly. The remaining percentage is represented by either licensed Kazakh affiliates of Western custodians or licensed Kazakh affiliates of Russian banks.

Russia: quality of services of Kazakhstani registrars

Over 70% of the respondents indicated their satisfaction with the services of Kazakhstani registrars. The respondents were asked to evaluate the quality of services by price, speed, convenience, additional services, and uninterrupted service, on a five-grade scale (5 is the highest mark). Marks for all these components were uniformly high. Some respondents mentioned the high cost for the services of the Kazakh affiliate of a Western custodian.

Russia: placement of securities in Kazakhstan

Most Russian respondents have no plans to introduce their securities to the Kazakhstani market. However, theoretically they would prefer direct trading on the Kazakhstani stock market (18%) as a method of introduction. This would enable them to avail themselves of the Central Depository services. This method of entering the Kazakhstani market is preferred because of its transparency and the exclusion of excessive mediators' fees. To date, Russian respondents show no interest in issuing KDR representing Russian securities.

Russia: problems of interaction with Kazakhstani financial institutions

Russian respondents mentioned the following problems of interaction with Kazakhstani financial institutions, e.g. registrars:

Table 8.8. Problems of interaction with Kazakhstani financial institutions

Absence of a full electronic document management system (SWIFT or similar) for interaction with the Central Depository.
Requirement to disclose beneficiary owner information as at the registration date within 24 hours[5].
Unclear regulations regarding depositing Russian securities with the Central Depository, Kazakhstani custodians and Russian depositories.

Potential sources of mutual portfolio investments

Theoretically, the resources of private pension funds or management companies can be viewed as potential sources of Russian portfolio investments in Kazakhstani securities. In accordance with the Federal Law no. 111-FZ dated July 24, 2002 (version of December 27, 2009), *On Investing for Financing the Funded Part of Pensions in the Russian Federation*, pension savings can be invested in:

- Russian federal government securities;
- bonds of Russian issuers;
- shares of Russian joint-stock companies;
- units (shares) of index investment funds which invest in foreign government securities, bonds and shares;
- mortgage-backed securities issued under Russian law;
- moneys in roubles deposited with credit organisations;
- deposits in roubles or foreign currency with credit organisations;
- foreign currency on accounts opened with credit organisations; or
- securities of international financial organisations permitted for placement and/or public trading in Russia in accordance with the Russian securities law.

[5] *Information on the beneficiary owner as at the registration date must be disclosed by a custodian within 24 hours, otherwise the client of the Russian professional player will not be eligible for the application of conventions on elimination of double taxation of securities which are not listed on the stock exchange (i.e. those taxed at a rate of 15%). Disclosure in such a short time span is not feasible because the procedure involves too many mediators. Not only banks but also their clients can act as nominal holders, i.e. within 24 hours the information received from a custodian in Kazakhstan must be delivered to the beneficiary owner (custodian in Kazakhstan – bank – bank's client – nominal holder – beneficiary owner), and then beneficiary owner information must be sent back to the Central Depository. In other words, the only option for clients is to disclose beneficiary owner information in advance, so as to eliminate the need for a custodian in Kazakhstan to request this information from a Russian professional player. This approach leads to the need to open several accounts with a custodian in Kazakhstan for registering the assets of clients/nominal holders who have several clients, hence increased account maintenance costs for these clients.*

To use these opportunities provided by Russian law, unitised investment funds holding Kazakhstani securities must be created. This is unlikely to happen in the near future, at least until the Kazakhstani capital market recovers from the global crisis and/or Kazakhstani securities are traded on the Russian market which offers adequate liquidity. An integrated currency market capable of supporting mutual convertibility of national currencies must be created within the CIS/EurAsEC framework; otherwise Russian professional players will have no incentive to deposit funds in tenge. This issue is discussed in more detail later.

Kazakhstani accumulative pension funds are active on the financial markets of Kazakhstan and other countries, and are important sources of long-term finance for the respective economies (FSA, 2009) (see Figure 8.10).

No significant Kazakhstani pension fund investments in Russian securities should be expected in the near future.

APF were established in the course of pension reform pursuant to the law On Pensions in the Republic of Kazakhstan (RK, 1997). In the last year alone their assets increased by 31% and totalled 1,860.5 billion tenge by the beginning of 2010 (FSA, 2009). They invest in foreign securities, including Russian securities, (see Figure 8.12), but this trend is likely to change in the near future. According to the above FSA report, at present

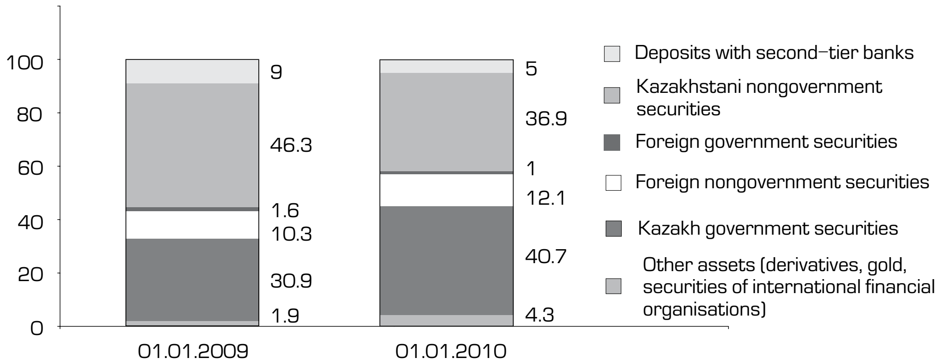


Figure 8.12. APF asset structure in Kazakhstan

the strategy of investing pension assets has been adjusted to favour Kazakh government securities (as a measure to ease domestic budgetary problems), and investment in foreign securities reduced as a consequence of this.

Main conclusions on the survey

Our research revealed that Kazakhstani players are interested in the Russian financial market principally as a source of financial resources. By contrast, Russian businesses view the Kazakhstani capital market as a springboard to Kazakhstan's natural resources. Most Kazakhstani organisations are keen to have their securities traded on the Russian market, whereas their Russian counterparts are not interested in the Kazakhstani market in this way. Russian stock exchanges show a degree of interest in cooperation with Kazakh partners and are prepared to list Kazakh instruments.

1. Most Kazakhstani respondents (about 17%) combine their broker/dealer business with investment portfolio management. Other combinations of professional activities vary from 6 to 12%, which illustrates the flexibility of Kazakh law. This leaves Russian investors and professional market players with plenty of choice of partners with the required functions in Kazakhstan.

2. Kazakhstani respondents who have affiliates in Russia (mostly banking structures, 17.6%), are approximately half as many as those who hold Russian securities (29.4%). 25% of Kazakhstani respondents hold securities issued by other jurisdictions.

3. In contrast to Kazakhstani organisations, Russian respondents maintain a stronger presence in the neighbouring capital market: some of them hold Kazakhstani securities and, at the same time, have affiliates in Kazakhstan.

4. The Russian capital market is attractive to Kazakhstani professional market players. Most of the Kazakhstani organisations that already hold Russian securities intend to buy more in the next six months. Over 30% of the respondents intend to buy Russian securities for the first time.

5. 29% (or, we assume, 35%) of Kazakhstani respondents hold Russian securities. Of this number, over 85% is represented in registers by depositories, and only 14% is represented directly. Of those represented in registers by nominal holders, equal numbers preferred the services of depositaries and Russian custodians.

6. The respondents show no interest in issuing KDR representing Russian securities – probably because these securities can be acquired directly.

7. 60% of the respondents expressed their wish to use electronic document management systems for interaction with Russian registrars.

8. Kazakhstani respondents mentioned the issuance of RDR, direct trading and creating conditions for settlement on Russian securities in Euroclear and Clearstream as their preferred methods for the introduction of Kazakhstani securities to the Russian stock market.

9. At present Kazakhstani professional players are not keen to introduce their securities to the Russian market, and so, to date, the problem of selecting professional Russian mediators for the introduction is not an urgent one. As there have been no RDR issuances, Kazakhstani market players have difficulty assessing their prospects for the use of this mechanism. Direct trading on the Russian stock market is naturally restricted by the stringent requirements imposed by Russian law.
10. Most Russian respondents have no plans to introduce their securities to the Kazakhstani market. However, theoretically, they would prefer direct trading on the Kazakhstani stock market (18%) as a method of introducing their securities. This would enable them to avail themselves of the Central Depository services. This method of entering the Kazakhstani market is preferred because of its transparency and the exclusion of excessive mediators' fees.
11. Kazakhstani players are interested in Russian financial market principally as a source of financial resources. By contrast, Russian businesses view Kazakhstani capital market as a springboard to Kazakhstan's natural resources. As a consequence, most Kazakhstani organisations are keen to have their securities traded on the Russian market, whereas their Russian counterparts are not interested in the Kazakhstani market in this way. However, Russian stock exchanges show a degree of interest in cooperation with Kazakh partners and are prepared to list Kazakh instruments.
12. Financial resources controlled by private pension funds or management companies can be viewed as a potential source of Russian portfolio investments in Kazakhstani securities. However, in order to make use of the opportunities provided by Russian law, unitised investment funds holding Kazakhstani securities must be created. This is unlikely to happen in the near future, at least until the Kazakhstani capital market recovers from the global crisis and/or Kazakhstani securities are traded on the Russian market which offers adequate liquidity.
13. Accumulative pension funds are active players on the financial markets of Kazakhstan and other countries. However, they should not be expected to make any significant investments abroad, particularly, in Russian securities. At present they are changing their investment strategy in favour of increasing their holdings of Kazakh government securities and cutting down investments in foreign securities.
14. Our survey covered Russia's main stock exchanges (RTS and MICEX) and their Kazakh counterpart KASE. RTS ranks highest among them in terms of investments in the other country. To date, only RTS has a

subsidiary in Kazakhstan (Commodity Stock Exchange ETS) and holds Kazakhstani securities.

Approaches to stock market regulation

- The issues of stock market development in Russia and Kazakhstan are closely interrelated with the issues of recovery from the global financial crisis.
- Kazakhstan's need for foreign investments is being addressed through prompt regulatory measures targeting financial institutions that meet this need on the domestic capital market.
- Whilst the Russian economy faces urgent problems of post-crisis recovery, no long-term financial market development policy is in place.

The analytical paper *On the Status and Development Trends of the Securities Market in CIS Member States* (CIS Executive Committee, 2009) concludes that the liquidity crisis and instability of international financial markets affected post-Soviet economies, including security markets. In 2008 the growth in the number of domestic issuers and capitalisation on the most developed CIS stock markets gave way to a decline in stock indices and market capitalisation levels of issuers, especially those whose instruments were traded internationally. The crisis highlighted the main problems and weaknesses of financial market regulation. A drop in liquidity of domestic stock markets and the market value of traded instruments and a rise in defaults by issuers on the organised CIS markets allowed the main areas of concern in the regulatory system to be identified: the protection of investors' rights and interests, maintaining the financial stability of issuers and professional securities market players, fair evaluation of instruments available for investment, as well as assessment and management of investment and operating risks.

The global crisis seriously affected the economic situation in Kazakhstan, and the Government started adopting measures to maintain the financial stability of the stock market (RK, 2003b). In particular, the mandatory charter capital size for market players was raised; this indirectly pushed Kazakhstani financial institutions into shareholding in foreign, e.g. Russian, entities. In 2009, in order to increase the financial stability of brokers/dealers who are authorised to maintain clients' accounts as nominal holders and perform certain banking operations, the procedure of equity size calculation and sufficiency ratios were optimised. As a measure to reduce external borrowing, FSA introduced capitalisation ratios for liabilities to non-residents. These are calculated as ratios of various liabilities to the professional player's equity.

Another step towards enhanced financial stability of professional securities market players was the revision by the FSA of a number of regulations

Kazakhstan's need for foreign investments is being addressed through prompt regulatory measures targeting financial institutions.

which set forth risk management requirements for organisations engaging in dealer and/or broker business or investment portfolio management. As part of this, a double control system (for execution and registration of financial transactions) was introduced; a stress-testing procedure was developed; the maximum permissible loss on client's assets for trust managers was set; and the procedure of making decisions on transactions in the player's own assets was made more elaborate (the requirement to set up an investment committee to this end was added); and internal audit of risk management systems was made compulsory. This comprehensive and modern approach by the Kazakh financial market regulator is in marked contrast to the FFMS' plans to switch to prudential supervision of securities market players. Clearly, Kazakhstan's need for foreign investments is being addressed through prompt regulatory measures targeting financial institutions.

In Russia, adjustments to financial market regulation are being made in line with the *Strategy of Development of the Financial Market of the Russian Federation until 2020* (RF, 2008), the Concept of Creating a Global Financial Centre in the Russian Federation (RF, 2009a) and the Plan of Action to achieve this (RF, 2009b). The purpose of these documents is to enhance the stability and competitiveness of the Russian financial sector; however, they were all prepared in 2008-2009. The Plan outlines the legal steps to create an international financial centre (IFC); these measures may appear to be instrumental in reaching this goal, but they are essential for normal operation of any market even if it does not attain IFC status. For example, the formulation of the objective to "create a compensation system on the financial market" contains no direct indications as to the content, cost or effects of the required system. This objective is assigned to a group of agencies: the FFMS, the Ministry of Economic Development, the Ministry of Finance and the Central Bank, which in itself gives rise to doubts about their ability to properly coordinate this effort. Even if all the measures named in the IFC Concept and Strategy are implemented, Moscow will not automatically turn into an IFC comparable with the world's top ten (Moscow and St. Petersburg currently rank 68th and 70th, respectively).

The progress of the Russian stock market on its way towards an IFC was slowed down not only (and not essentially) by the crisis, but also by the inefficient regulatory system.

What the FFMS really should do in order to accelerate the formation of an IFC is to provide a regulatory framework for trading in foreign securities in Russia.

Notably, the IFC Concept and Strategy were developed before and during the 2008 financial crisis. However, the progress of the Russian stock market on its way towards an IFC was slowed not only (and not critically) by the crisis, but also by the inefficient regulatory system.

Currently, the world's largest financial centres, including the US and the UK, are revising their approaches to regulation, trying to draw lessons from the crisis. Russia's main partner in EurAsEC and the Customs Union, Kazakhstan, also responded quickly to the challenge. In February the President of Kazakhstan approved the *Concept of Development of the Financial Sector of the Republic of Kazakhstan in the Post-Crisis Period* (RK, 2010). This document defines the ultimate goal as "the development of the financial sector in the post-crisis period, particularly, elevating it to a new qualitative level of management and regulation".

The Concept provides that regulation and supervision of the financial sector will be based on the counter-cyclical policy principle (i.e. formation of reserves and increasing equity capital and liquidity during periods of economic upsurge so that to use this accumulated potential during recession). The same principle applies to the structure and quality of investment portfolios of financial organisations. The document stresses the importance of getting rid of pro-cyclic approaches in regulation. Notably, similar Russian documents do not seem to contain any underlying principle at all.

The Kazakhstani Concept includes five sections addressing the key aspects of the functioning of the financial market:

1) definition of the state's role in mobilising financial resources;
2) strengthening the regulatory and supervisory systems;
3) strengthening mechanisms for protecting the rights of investors and consumers of financial services;
4) enhancing the quality of corporate governance and transparency of financial organisations; and
5) managing systemic risks and interaction between governmental agencies.

The Kazakhstani Concept also addresses the issues of government interference with the economy. The government will assume a more prominent role in planning and stimulating the economy, but the basic principles of free market and free private sector will be preserved. The state will switch from full social support for various population groups to a mixed system where employees will share responsibility for their welfare with employers and the government. As the first step in this direction, a savings pension system was adopted in Kazakhstan; the goals of this pension reform were to reduce public expenditure, and, equally importantly, to create a new class of institutional investors.

Private-public partnership will become the main engine of economic modernisation in Kazakhstan. Accumulative pension funds will be encouraged to invest in infrastructure projects. Individual and corporate deposits with second-tier banks are viewed as the main potential source of funds for the financial sector. Islamic financing will also be developed as an additional source of funding.

Private-public partnership will become the main engine of economic modernisation in Kazakhstan. Accumulative pension funds will be encouraged to invest in infrastructure projects. Individual deposits with second-tier banks are viewed as the main (albeit conservative) potential source of funds for the financial sector. The Concept also places an emphasis on the government securities market; notably, corporate securities are assigned a secondary role, as this segment is still largely underdeveloped. It is envisaged that "the existence of a moderate budgetary deficit and manageable government debt will permit the circulation of an adequate quantity of governmental securities at all times; this quantity will be instrumental in drawing a yield curve, defining short and longer term expectations, assessing the risks to which financial instruments are exposed, and determining spot rates for prospective borrowings".

The Kazakhstani Concept states that the volume of medium and long-term government securities (issued in order to cover the budgetary deficit) must be determined by the capacity of the domestic securities market. Alternative sources of savings, such as private institutions, real estate funds and hedge funds, will also be widely employed.

Islamic financing is also named as an additional source of funds. The conditions necessary for the establishment of Islamic banks and investment funds and issuing Islamic instruments were created by amendments to the respective laws made in February 2009 (RK, 2009). In contrast, Islamic financing is not even mentioned in the IFC Concept and Strategy of Russia, a country with a multimillion Muslim community. Regulation and supervision of Islamic financial organisations in Kazakhstan will be the responsibility of the FSA. The main platform for the development of the Islamic instruments market will be the Agency for Regulation of the Regional Financial Centre of Almaty (the RFCA Agency). This distribution of responsibilities reflects the somewhat dual nature of the Kazakh regulatory system, which first manifested itself following creation of the RFCA Agency pursuant to Law no. 145, *On the Regional Financial Centre of Almaty*; thus, the short-lived integrity of the regulatory powers of the FSA was to some extent weakened. The RFCA Agency is authorised to:

- approve the rules for state registration (re-registration) of entities that are participants in RFCA;

- approve the rules of accreditation of participants in RFCA;
- set requirements for issuers whose securities are proposed for listing or listed on the special trading floor of RFCA, and, jointly with the FSA, requirements for these;
- approve the list of rating agencies whose ratings are recognised by FSA;
- set rating requirements for securities and issuers applicable on the special trading floor of RFCA, etc.

The authors of the Kazakhstani Concept paid close attention to strengthening the regulation and supervision of the financial market. It is stressed that integrated control can exclude conflicts of interests which are inevitable under functional or institutional supervision systems. In other words, all Kazakhstani financial institutions will remain accountable only to FSA, although the RFCA Agency is vested with some law-making powers which overlap those of FSA. The Chairman of the RFCA Agency is a member of the FSA Board; this body, for example, controls KASE, whose largest shareholder (12.26%) is RFCA. This overlapping power and responsibility has the potential to generate conflicts of interests.

In Russia, the same financial institutions are regulated and supervised by the FFMS, the Central Bank, the Federal Financial Monitoring Service, the Ministry of Finance and Social Development, and others.

The current regulatory system of the Russian capital market is cumbersome and overly complex compared to the Kazakhstani system. The above mentioned Russian documents also contain provisions on modernisation of financial market regulation, but these are essentially general statements. It is recognised that the current intention is not to create a consolidated regulatory body, but to improve the coordination of the existing ones. To this end, it was proposed that interministry coordinating structures such as the Presidential Council on Development of the Financial Market (actually established in 2009) and an IFC working group attached to it be created. The Strategy recognises the need to switch from the principles of industry-specific (functional) regulation to state-level regulation of financial market risks (threats to financial stability, unscrupulous activities and violation of the rights of investors and market players). However, even the crisis did not push the Russian regulatory bodies into practical action in this sphere.

In contrast, the Kazakhstani regulatory system made significant progress in this respect. In line with the Kazakhstani Concept, the supervisory body will impose additional requirements for financial organisations concerning transparency of decision-making on foreign investments and lending. This will allow the risk of transactions with countries exposed to high legal risks and inadequate protection of the rights of investors and lenders to be reduced.

The Russian Concept stresses the inefficiency of industry-specific banks, as these institutions cannot function properly in a competitive environment and need government support. The Russian financial market (and, first of all, the banking sector) is dominated by structures with heavy government shareholding, and their role as recipients of government resources intended for maintaining the liquidity of the financial system was boosted even further by the crisis.

The message of the Kazakhstani Concept is that government support for the financial market must be gradually reduced. The Russian documents do not contain any indications of the government's forthcoming withdrawal from the market, e.g. the Central Bank's withdrawal from the capital and management of MICEX. However, the reductions of government shareholdings in Sberbank and VTB are planned for 2011-2013.

The message of the Kazakhstani Concept is that government support for the financial market must be gradually reduced. Thus, the government intends to reduce its interference with all market segments and fully withdraw when an adequate level of fair competition is achieved.

Notably, the Russian documents do not contain any indications of the government's forthcoming withdrawal from the market, e.g. the Central Bank's withdrawal from the capital and management of MICEX. However, the possibility of reducing government shareholding in Sberbank and VTB has recently been voiced.

The Kazakhstani Concept envisages that foreign participation in the financial sector will be limited to 50% of total equity capital. The Russian documents do not address this issue, although certain legal barriers to foreign capital in the banking sector do exist.

In order to better protect the interests of investors and consumers of services on the Kazakhstani securities market, the responsibility level of senior management of joint-stock companies will be increased; stricter transaction transparency requirements will be introduced, corporate governance systems will be improved, and issuer information disclosure will be regulated in more detail.

Corporate governance and transparency of Kazakhstani financial organisations will be enhanced by introducing requirements for internal audit, risk management systems, information disclosure and fair evaluation of financial instruments. The Russian Strategy also addresses these issues and provides for similar measures. The Kazakhstani Concept contains provisions on strengthening macro-prudential supervision, which includes a package of measures for eliminating systemic risks. The purpose of this form of regulation is to identify key solutions on particular activities and markets that are exposed to systemic risks which threaten financial and economic stability.

The Russian Strategy also provides for creating a system of prudential supervision at several levels: internal audit of financial market players, control of self-regulating organisations, and state control by government agencies. The other proposed measures include:

- harmonisation of methods and rules of supervision of professional securities market players and the banking supervision rules;
- adoption of common requirements on calculation of equity capital (consistent with international standards) for all professional securities market players and unit investment fund management companies in parallel with the modernisation and unification of accounting rules applicable to financial organisations;
- revision of requirements for the minimum equity capital size to international standards;
- adoption of requirements for capital sufficiency in view of the organisation's financial risks;
- adoption of advanced risk assessment methods based on internationally recognised models, including ratings and digital indices reflecting operating risks.

The Russian Strategy outlines the principle of proportionality of prudential supervision – that is, supervisory requirements should apply to market players with due regard for their size, type of activity, nature of transactions and related risks. A prudential supervision system should employ an individual approach towards assessing risks to which market players or their assets are exposed. Unfortunately, the current FFMS practice is not consistent with the proportionality approach; a problem which is discussed in more detail below. It should also be noted that, whereas the Kazakhstani Concept upholds the principle of counter-cycle policy, the Russian Strategy and the current practices of Russian regulatory bodies focus principally on stiffening equity capital size requirements for non-banking players, which is being presented as implementing international recommendations, although with no regard for the current phase of the economic cycle. The Kazakhstani regulatory system will employ a new index reflecting recovery of the banking sector – namely, ratio of banking system assets to pre-crisis GDP, although the current

The development of the Kazakh financial market will follow the principle of counter-cycle policy. The Russian Strategy and the current practices of Russian regulatory bodies focus principally on stiffening equity capital size requirements for non-banking players, although with no regard for the current phase of the economic cycle.

structure and quality of the assets are largely different from the pre-crisis pattern.

Our comparison of two approaches towards financial market development allows us to conclude that the Kazakhstani Concept is a fairly consistent document which covers both the banking and non-banking segments of the financial market and addresses the problem in a comprehensive and systematic manner. Unlike similar Russian documents, it is more fundamental and conveys a clear message for financial market players and investors as to the prospective changes in state regulation. On the other hand, the Russian documents present merely general statements rather than practical formulae. Whilst the Russian economy is facing the urgent problems of post-crisis recovery, no long-term financial market development policy is in place.

Interaction between Russian and Kazakhstani stock exchanges for capital markets development

- Russian and Kazakhstani stock exchanges as main organisers of trade are keen to cooperate with each other.
- During the past decade a great deal of organisational work was done in both countries, however we still cannot say that an adequate level of integration was achieved nor can we say that we are nearing a common stock exchange space.

Interaction between Russian and Kazakhstani stock exchanges

Stock exchanges are the central elements of a financial infrastructure. Occupying a position between monetary authorities/regulatory bodies and stock market players, they not only organise trade and facilitate settlement, but also serve as a vehicle for change and innovation.

The Russian and Kazakhstani stock exchanges are striving to expand mutual cooperation. It is natural, in view of the fact that MICEX, RTS and KASE are all members of the International Association of Stock Exchanges of the CIS (IASE). The goals of this organisation are (CIS IASE, 2000):

- the formation of a single stock exchange space based on advanced stock trading technology;
- mutual admission of non-resident traders;
- the facilitation of national currency flows between CIS countries;
- the adoption of international securities market standards in CIS countries and mutual recognition of issuance registrations;
- cooperation between CIS members in capital market and single stock exchange space development;

- the development of basic standards for unification of the interbank capital market;
- cooperation in the development of currency and lending transactions on national currency markets;
- the formation of the CIS monetary system based on national currencies;
- practical implementation of the principle of mutual recognition of national currencies and official quotations;
- achievement of mutual convertibility of national currencies for the purposes of current transactions;
- the introduction of mechanisms and instruments for currency, interest and price risk hedging;
- support for floating national currency rates and approval of maximum fluctuations;
- the introduction of a banking mechanism and market makers for the purposes of supporting national currencies and achieving full convertibility of such currencies.

The goals declared by IASE CIS are very challenging, and they are much more precisely formulated than any international agreements in this sphere. Of course, the achievement of these goals does not entirely depend on the stock exchanges themselves, yet the formulation of these goals indicates that the stakeholders wish to cooperate on definite terms. It does not really matter whether this cooperation will be in the CIS, EurAsEC or bilateral format; what is important is that the IASE CIS is in a position to make a positive contribution to this process.

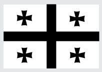
The International Association of Stock Exchanges of the CIS was founded in April 2000 in Moscow in an effort to coordinate the creation of organised financial markets to international standards.

CIS IASE comprises 20 organisations from 10 CIS countries which play the central role in servicing mutual financial flows, currency operations and transactions in government and corporate securities.

Azerbaijan (Baku Interbank Currency Exchange)

Armenia (NASDAQOMX Armenia)

Belarus (Belarusian currency and stock exchange, Belarusian Universal Commodity Exchange)



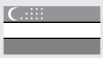
Georgia (Tbilisi Interbank Currency Exchange)

Kazakhstan (KASE, Central Securities Depository)

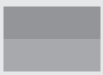
Kyrgyzstan (Kyrgyz stock exchange)

Moldova (Moldovan Stock Exchange)

Russia (MICEX, Samara Currency Interbank Exchange, SPCEX, Siberian Interbank Currency Exchange, RTS)



Uzbekistan (UZSE, Uzbek Republican Commodity Exchange)



Ukraine (National Depository of Ukraine, Interbank Currency Exchange of Crimea, Ukrainian Interbank Currency Exchange, FSTS)

The persisting global crisis hit stock trade hard, especially the trade in securities. Of the 130 companies listed on KASE, 24 defaulted on their debt instruments, and five of these 24 companies defaulted on coupons and the principal. Many companies are more than one coupon period in arrears. These include two largest Kazakh banks, Alliance Bank and BTA Bank, whose indebtedness to bond holders (29.7 billion tenge) accounts for 56% of the total indebtedness on bonds of all defaulting companies.

The Kazakh financial authorities promptly responded to this negative impact on stock trade by revising the securities law in two ways. First, listing requirements for certain categories of instruments and issuers were lowered. This stabilisation measure had been applied in international practice to resolve similar problems, and the FSA decided to learn from this experience. The softening of listing requirements allowed some companies to recover from a financial setback and remain on the official list despite their deteriorated financial performance indicators.

Particularly, amendments were made to FSA Board Resolution no. 77 dated May 26, 2008, *On Requirements for Issuers and Instruments Permitted to Trade on the Stock Exchange and Certain Listing Categories*. The mandatory equity capital size of debt securities issuers was reduced, the requirement to employ a market maker for certain categories of debt securities was lifted, and the profit periods requirement was eased. These amendments to the listing requirements were dictated by the fact that during the crisis many listed Kazakhstani companies suffered losses and, accordingly, their equity capital size shrank.

Second, a special buffer category of securities was added to the official list. It is stated that this measure is aimed at protecting the rights of crisis-stricken issuers: they are given an opportunity to remain on the official list, although with a reduced status. These issuers can continue introducing their instruments to the stock exchange, which, in the opinion of the authorities, is less detrimental from a systemic point of view than delisting.

The above measures undoubtedly played a role in stabilising the Kazakhstani stock market; however, the number and scale of continuing defaults seriously concerned potential Russian buyers of Kazakhstani securities, and this sentiment still persists. For comparison: in 2008, 16 Russian bond issuers defaulted on coupon payments on 20 issuances, 21 issuers defaulted on offers on 22 issuances, and 1 issuer defaulted on maturity; in 2009, 50 issuers defaulted on coupon payments on 60 issuances, 41 issuers defaulted on offers on 46 issuances, and 17 issuers defaulted on maturity. Of course, these negative developments do not appear as severe as the Kazakh defaults in the context of the Russian market size: as at September 1, 2009, MICEX traded 578 corporate bond issuances of 409 companies for a total of 2,000 billion roubles and 18 commercial paper issuances of

6 issuers for a total of 58 billion roubles, and had on its list 248 corporate bond issuances (42.5% of the total number) and 4 commercial paper issuances of 3 issuers; in addition, 14 commercial paper issuances were traded in the off-list sector.

During the past decade a great deal of organisational work was done in both countries, however we still cannot say that an adequate level of integration was achieved nor can we say that we are nearing a common stock exchange space. This conclusion is confirmed by the results of our survey which covered RTS and MICEX of Russia and Kazakhstan's main stock exchange KASE.

RTS ranks highest among them in terms of investments in the other country. To date, only RTS has an affiliate in Kazakhstan (Commodity Stock Exchange ETS) and holds Kazakhstani securities.

It should be noted that both RTS and MICEX head vertically integrated financial groups comprising various organisations. This allows a choice of specialised partners for cooperation with Kazakhstan in different aspects of financial markets integration. KASE also has affiliates and dependent business entities in its organisational structure with similar functions and roles.

All these stock exchanges are shareholders of other CIS stock exchanges, and this determines their preferences in cooperation to some extent. For example, RTS is implementing several joint projects with foreign counterparts, and KASE has a 10.6% stake in the Kyrgyz Stock Exchange (unfortunately, in view of the recent events in Kyrgyzstan, this is unlikely to bring about any positive developments in the near future). The intention to cooperate is already there, and this intention takes various practical forms.

During the survey the respondents were asked about prospective forms of cooperation between Russian and Kazakhstani stock exchanges. MICEX provided the most extended answer to this question:

- exchange of information on working plans, stock market development prospects, improvements to trading systems, interaction with clearing, depository and settlement systems, and adoption of new technology and instruments;
- technical cooperation;
- bilateral commercial projects;
- mutual penetration of stock markets by Russian and Kazakhstani players;
- organisation of trade in RDR and KDR;

- direct admission of Kazakhstani issuers to Russian stock exchanges;
- clearing services;
- disclosure of corporate information of Russian and Kazakhstani issuers;
- joint efforts to develop CIS countries' markets under the aegis of IASE CIS;
- participation in CIS and EurAsEC bodies, the Russian-Kazakh Commission on Economic and Financial Issues, etc.

KASE mentioned the following prospective areas of cooperation with Russian counterparts:

- harmonisation of two countries' laws, as a precondition for stock market integration projects;
- consultations on strategic development, PR and marketing;
- exchange of information for the purposes of attracting investors;
- exchange of experience related to IT infrastructure and trading and clearing systems in order to enhance efficiency and quality of services;
- cooperation in developing IT solutions for the Kazakhstani derivatives market.

In the short term, the main focus should be on the integration of the Russian and Kazakhstani stock exchanges as the organisers of the most developed markets in EurAsEC.

Effectively, ETS (launched in 2009) and the prospective Eurasian Stock Exchange are competing projects on the farm produce market. They should be integrated, perhaps on the basis of the ETS which is already operational.

In the short term, the main focus should be on the integration of the Russian and Kazakhstani stock exchanges as the organisers of the most developed markets in EurAsEC (IASE, 2009). A positive example of integration on the commodity market is the creation of the Eurasian Trade System stock exchange in the end of 2008 by the RFCA (40% of the charter capital) and RTS (60%). Unfortunately, as the crisis persists, to date only the farm produce section is operational, although oil products and metals sections are to be launched. We should also mention the project to create the Eurasian Stock Exchange of Farm Produce, Raw Materials and Foodstuffs which is being developed on the initiative of the EurAsEC Integration Committee, and which effectively competes with the above project. The new stock exchange will be based on the Belarusian Universal Commodity Exchange and is expected to start in 2011. If this project becomes a success, it should be integrated into the ETS through a mechanism suitable for all participants – such as the existing trading floor in Almaty.

Although the main responsibility for simplifying interaction between organised market players from two countries lies with the stock exchanges themselves, not everything depends on them. For example, as we have mentioned above, both the stock exchanges and professional capital market players such as central depositaries need an adequate nominal holding mechanism for foreign investors which would fit with the laws of two states, and a developed clearing system including centralised functions.

Stock exchanges, depositaries and other professional capital market players need an adequate nominal holding mechanism for foreign investors which would fit with the laws of two states, and a developed clearing system.

Another important element of technical integration is the development and introduction of a common electronic document management technology which would allow information exchange between stock exchanges and traders to be standardised and accelerated.

Preconditions and problems of integrated currency market development

Professional financial market players from Russia and Kazakhstan understand that economic cooperation between these two countries will expand steadily despite the persisting global crisis. The preconditions for an integrated currency market are already there: the experience of interaction and mutual ties between Russian and Kazakh banks, including shareholding, and extensive market infrastructure.

Although currency regulation varies across the CIS and EurAsEC in terms of openness, prior to the crisis there was a clear overall tendency towards liberalisation of currency laws. Generally, the currency markets in CIS countries demonstrate positive growth dynamics. The crisis resulted in significant changes in CIS currencies' exchange rates, and companies and the population at large started to show greater interest in currency exchange transactions, hence an increase in currency market turnovers (Mishina, 2009).

However, the volume of transactions in CIS national currencies on the Russian interbank market remains negligible[6]. In September 2009 the total volume of currency conversion transactions reached $52 billion a day. Transactions in the Ukrainian hryvnia and Kazakh tenge totalled $6 million, and transactions in the Belarusian rouble about $1 million a day – less than 0.01% of the Russian currency market turnover. Notably, even these small exchange transactions involved the US dollar rather than the Russian rouble.

[6] *http://www.eabr.org, http://infoshos.ru.*

99% of all transactions on the Kazakh interbank market involve the US dollar. In 2008, stock trade in the US dollar increased by 9.1% to \$66.6 billion. At the same time, trade in the US dollar dropped by 26.4% to \$103.5 billion on the unorganised market. Transactions in the Russian rouble and euro accounted for less than 1% of the total turnover of the organised and unorganised segments of the currency market. On stock exchanges, transactions in the Russian rouble grew by 39.5% to 573.8 million Russian roubles, and euro transactions grew by 3.3% to €11 million. In the unorganised segment, transactions in the Russian rouble dropped by 2.1 times to 1.9 billion Russian roubles, whereas euro transactions grew by 7.5% to €588.5 million (Mishina, 2009).

The reluctance to make payments in CIS national currencies and the use of the US dollar or euro result in higher transaction costs, inconvenience of mutual payments under financial transactions, and the need to maintain additional sums in foreign currencies – hence unnecessary currency risks.

According to IASE CIS, in 2008 the total volume of trade in foreign currency on the member stock exchanges reached \$2.8 trillion – a 78% increase over the previous year's figure. Trade in the Russian rouble in 2008 was especially extensive in Belarus: Russian rouble transactions on the Belarusian Currency Stock Exchange (BCSE) totalled 124.4 billion roubles, accounting for more than 27% of all currency transactions. On KASE, tenge-US dollar transactions account for 99% of all currency transactions and rouble and euro transaction amount to less than 1%. On MICEX, transactions in CIS national currencies are very rare: the last rouble-tenge transaction took place in 2000. Taking the objective of developing an integrated currency market as indicated in the EurAsEC Agreement (EurAsEC, 2006) into account, MICEX started preparing a project to stimulate trade in soft currencies (namely, receiving liquid direct quotations without US dollar mediation). On November 2, 2009 MICEX introduced new rules which grant EurAsEC countries' residents the right to become members of the MICEX currency market section. Banks from EurAsEC countries will be able to participate in "Single Regular Trading" after the respective national (central) banks sign an agreement with the Central Bank of Russia.

An analysis of the soft currencies market shows that its efficiency largely depends on efforts to improve the settlement infrastructure and regulatory support from Russian and Kazakh governmental agencies. The commencement of the Agreement on the Customs Union of Russia, Kazakhstan and Belarus in July 2010 created the conditions for the resumption of talks on adoption of a common currency by these three countries. This step would elevate the stock market integration effort to a new level and have a diverse effect on various economic sectors.

Conclusions

This study conducted by the Eurasian Development Bank with support from the PARTAD enables an assessment of the prospects and problems of integration of the capital markets of Russia and Kazakhstan. In technical and legal terms, these problems are largely similar to those faced by the capital market integration effort in EurAsEC as a whole. Our analysis of the legal framework for mutual penetration of Russian and Kazakhstani capital in the form of stock market instruments shows that there are no insurmountable barriers to this process. Moreover, the basic legal preconditions for this mutual penetration are all in place. However, as the financial crisis persists and the capital markets of Russia and Kazakhstan fail to function as a single IFC in the global financial market, this mutual penetration is still of little use.

Notably, these two EurAsEC member countries have no explicit political or other barriers to integration of capital markets. This warrants synchronisation of their regulatory systems and infrastructure, which will allow them to quickly and efficiently organise trading in Kazakhstani securities and depository receipts on Russian exchanges; to secure reliable communication between the holder, the issuer and the registrar by electronic document management systems; and to enable the disclosure of information on these financial instruments at a single EurAsEC centre, irrespective of location, in both Russian and English.

The survey reveals that currently potential issuers and professional players show little interest in the integration of the stock markets of Russia and Kazakhstan and prefer to work on international markets. Thus, competition with other financial centres necessitates significant effort to improve the attractiveness of regional financial solutions and instruments.

Accordingly, the ultimate goal should be defined as a common Eurasian financial centre with infrastructure elements lokated across EurAsEC and form a single exchange trade, clearing and settlement system. Most of these elements will be concentrated in Russia, due to some significant economic or technical advantages. Nonetheless, other EurAsEC members (primarily, Kazakhstan) will have a role to play in the capital and physical infrastructure of the main institutions of this supranational IFC.

As part of this effort, the EDB can position itself as a unique institution which can not only catalyse the investment process but also serve as an infrastructure bridge between the capital markets of Russia and Kazakhstan and, potentially, other EurAsEC countries. This is especially important because, according to the survey, the level of mutual Russian and Kazakhstani capital market penetration does not match the actual potential for bilateral cooperation.

Decision-making on capital market integration issues could be greatly accelerated if, following the inception of the Customs Union of Russia, Kazakhstan and Belarus (which seemed unrealistic just a short time ago), the issue of a common currency is once again placed on the political agenda. The adoption of a common currency would spur diverse synergetic effects in the economies of the member countries. In the short - to medium term a broader use of national currencies in mutual trade could have positive effect on the integration of capital markets.

To date, the most serious concerns are centred around the fact that, though the Russian economy faces the challenges of post-crisis rehabilitation, no strategic documents or policies have yet been formulated on the development of the Russian financial market as the backbone of an integrated EurAsEC capital market. This is a dangerous oversight in the context of tough competition between developing markets.

We hope that this publication will contribute to the policy-making and formulation of measures for the development of the capital markets in Russia and Kazakhstan.

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The Waves of Eurasian Exchange

9

Evgeny Vinokurov

Introduction

The current processes of intensive economic interaction are not unique if we look back at the last two thousand years of world economic history. We utilise a notion of "Eurasian exchange" coined, in particular, by Jeofrey Gunn[1]. We will describe a Eurasian exchange as the mutual exchange of goods, services, people, information, ideas and technologies along established routes across the Eurasian continent. This phenomenon shaped the human civilisation more than once of the last two millennia. In this chapter we will outline distinct "waves" of Eurasian exchange and trace their differences and similarities as concerns their thematic and geographic focus as well as the primary means of communication.

We rely on the body of literature primarily by the school of world systems historians, such as Janet Abu-Lughod, Andre Gunder Frank, and Kenneth Pomeranz (as well as, of course, Angus Maddison for the overall macro-economic history), probably starting with Fernand Braudel. In essence, these historians argue that the world history has to be reassessed. From a global perspective Asia – and not Europe – held center stage throughout most of the modern history. Before 1800 Europe – or, for that matter, the "West" – was not hegemonic structurally, nor functionally, nor in terms of economic weight, or of production, technology or productivity, nor in per capita consumption, nor in the development of capitalist institutions (Frank, 1998: 5).

Four Eurasian exchanges

There were four distinct periods of large-scale Eurasian exchanges which were both the product and the defining forces of major economic and technological breakthroughs:

1-3th centuries A.D.: exchanges between Roman Empire, Middle East, India and China under Han dynasty. These exchanges were greatly facilitated by the political unification of the Mediterranean under the Rome and China under Han dynasty.

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[1] *Gunn (2003) is more concerned with the cultural/civilisational side of the picture, while we focus on the economic side.*

11-13th centuries: This is the time of multiple Silk Ways, which we outline below. However, despite the romantic flair of the Silk Ways, maritime routes were more important in terms of volume of trade than the land routes. Arab traders served as the major force in this era of Eurasian exchange.

16-19th centuries: time of maritime trade and gradual European expansion in the Indian ocean and in the Pacific. Although Europeans led the drive, their role in absolute terms requires a qualification. According to contemporary research, the major bulk of trade exchange was still between the Asian trade partners. Also, the exchange of technologies was certainly mutual (Frank, 1998; Gunn, 2003).

Approximately since the 1970s: contemporary wave of Eurasian exchange as an instance of globalisation. Maritime transportation firmly becomes the principal means for goods exchange. Still, the major feature of the contemporary, fourth Eurasian exchange is that there are essentially new means of exchange, whose economic value may be difficult to measure directly against trade in goods, most importantly telecommunication and information exchange, but also air transportation (which greatly advanced the exchange of people and ideas). The technological advances in transportation and telecommunications helped intensify the global exchange by many–fold (the whole 17th century Asian trade could have been served by one transocean container vessel!).

An important feature of the first, second and third exchanges is that the role of Europe was not central. In fact, the 'Western' civilisation firmly held the hegemony only since the very end of the eighteenth century. As it is changing now, the overall period of Western hegemony is likely to be restricted by 200 years – out of five millennia of charted history of the human race. Any attempts to retouch this (such as reclassifying Japan as part of the "West") are doomed.

Eurasia itself is a Eurocentric denomination, albeit one invented on a distant marginal peninsula of that land mass. "Asiopa" is statistically more correct! Or, rather, "the relevant geographic and historical unit is really "Afro-Eurasia" (Frank, 1998: 2). From the point of view of the political, demographic, and economic history, as well as anthropology, it could also be called "Afrasia'. Still, we have no choice but to stick to Eurasia (just remember that under different circumstances our book might be entitled "Asiopian Integration").

To provide a few figures for comparison, modern demographers place China's population in 1500 at 100 million, compared with Europe's 68 million (and Japan's 16 million). By 1800, China's population would rise to over 300 million (300 years of peace), vastly outstripping Europe with 173 million (Frank, 1998: 171).

The city of Hanchow in the 13th century had probably a million inhabitants and was – until 19th century London (!) – the world's largest city (Abu-Lughod, 1989: 337). China was as good the central piece of the 2nd Eurasian exchange and a central piece of the third one, as it absorbed two thirds of the world silver in exchange for its higher value-added production of silk, ceramics, tea, etc.

Below we reproduce the abridged version of the table on world population by Clark (see Table 9.1). His calculations largely coincide with other influential historians who charted the world's demography.

Year	1200	1500	1600	1650	1700	1750	1800
World	348	427	498	516	641	731	890
Europe	51	68	83	90	106	130	173
Asia	248	231	303	311	420	484	590
China	123	100	150	100	150	207	315
Japan	12	16	18	22	26	26	26
India	75	79	100	150	200	200	190
Africa	61	85	100	100	100	100	100
Americas	23	41	15	13	13	15	25
Oceania	1	2	2	2	2	2	2

Table 9.1.
World Population 1200–1800 (million, estimates by Clark)
Source: Clark, 1977

The population of China was steadily 1.5-1.7 times larger than the totality of Europe. Japan's population is equal to those of the largest European nations, France and Great Britain. Asia makes roughly two thirds of the world population, compared to 20% or less of Europe.

The calculation of GDP would not be much different, as per capita GDP in China and Japan was equal or higher than that of the European nations well until the 19th century. E.g. in 1750 total world GNP was $155 billion (measured in 1960 US dollars), of which 77% was in Asia[2].

In terms of per capita income, Europe and China (and probably India) attained comparable levels of development between 1000 and 1500. In fact, China enjoyed higher levels of per capita income, technological advance etc. in 11-15th centuries (Pomeranz, 2000).

The standard figures by Maddison confirm this view (see Table 9.2).

Let us summarise some characteristics of the four Eurasian Exchanges *in Table 9.3*.

[2] *Braudel (1992) citing estimates by Paul Bairoch; his "Asia excludes Russia and Japan. If we include them back to where they belong geographically, Asian share would be in excess of 80%.*

Years A.D.	1	1000	1500	1600	1700	1820	1870	1913	1950	1973	2003
Western Europe											
Population (thousand)	25050	25560	57332	73788	81460	133040	187504	260975	304941	358825	394604
GDP ($ million)	14433	10925	44183	65602	81213	159851	367466	902210	1396078	4096764	7857394
GDP (per capita, $)	576	427	771	889	997	1202	1960	3457	4578	11417	19912
USA											
Population (thousand)	680	1300	2000	1500	1000	9981	40241	97606	152271	211909	290343
GDP ($ million)	272	520	800	600	527	12548	98374	517383	1455916	3536622	8430762
GDP (per capita, $)	400	400	400	400	527	1257	2445	5301	9561	16689	29037
Latin America											
Population (thousand)	5600	11400	17500	8600	12050	21591	40399	80935	165938	307873	541359
GDP ($ million)	2240	4560	7288	3763	6346	14921	27311	120796	415328	1389460	3132145
GDP (per capita, $)	400	400	416	438	527	691	676	1493	2503	4513	5786
Japan											
Population (thousand)	3000	7500	15400	18500	27000	31000	34437	51672	83805	108707	127214
GDP ($ million)	1200	3188	7700	9620	15390	20739	25393	71653	160966	1242932	2699261
GDP (per capita, $)	400	425	500	520	570	669	737	1387	1921	11434	21218

Years A.D.	1	1000	1500	1600	1700	1820	1870	1913	1950	1973	2003
China											
Population (thousand)	59600	59000	103000	160000	138000	381000	358000	437140	546815	881940	1288400
GDP ($ million)	26820	26550	61800	96000	82800	228600	189740	241431	244985	739414	6187984
GDP (per capita, $)	450	450	600	600	600	600	530	552	448	838	4803
India											
Population (thousand)	75000	75000	110000	135000	165000	209000	253000	303700	359000	580000	1049700
GDP ($ million)	33750	33750	60500	74250	90750	111417	134882	204242	222222	494832	2267136
GDP (per capita, $)	450	450	550	550	550	533	533	673	619	853	2160
Other East Asia											
Population (thousand)	11400	21100	37600	43600	50700	64228	89506	145893	333310	565057	1018844
GDP ($ million)	4845	8968	20822	24582	28440	36451	53155	122874	256938	839258	3926975
GDP (per capita, $)	425	425	554	564	561	568	594	842	771	1485	3854
West Asia											
Population (thousand)	19400	20000	17800	21400	20800	25147	30290	38956	59847	112918	249809
GDP ($ million)	10120	12415	10495	12637	12291	15270	22468	40588	106283	548120	1473739
GDP (per capita, $)	522	621	590	591	591	607	742	1042	1776	4854	5899

Table 9.2. World population and economy, 1–2003 AD (estimates by Maddison)

Source: Maddison (2003), Statistical Appendix A, tables A1, A4, and A7.

Years A.D.	1	1000	1500	1600	1700	1820	1870	1913	1950	1973	2003
Total Asia (excl. Japan)											
Population (thousand)	165400	175100	268400	360000	374500	679375	730796	925689	1298972	2139915	3606753
GDP ($ million)	75535	81683	153617	207469	214281	391738	400245	609135	830428	2621624	13855834
GDP (per capita, $)	457	466	572	576	572	577	548	658	639	1225	3842
Africa											
Population (thousand)	17000	32300	46610	55320	61080	74236	90466	124697	228181	390202	853422
GDP ($ million)	8030	13835	19383	23473	25776	31266	45234	79486	203131	549993	1322087
GDP (per capita, $)	472	425	414	422	421	420	500	637	890	1410	1549
World											
Population (thousand)	225820	267330	438492	556148	603190	1041695	1271919	1791091	2525205	3916493	6278620
GDP ($ million)	105402	120379	248445	331562	371428	694598	1110951	2733365	5331689	16022888	40913389
GDP (per capita, $)	467	450	566	596	616	667	873	1526	2133	4091	6516

Eurasian exchanges	Routes	Which way
First, 1-3 century A.D.	Sea and land	Roman Empire – West Asia – India – China
Second, 11-13th A.D.	Sea and land (Silk Ways)	More between Arab world, South, and East Asia; Europe on the margins of Eurasian trade
Third, 16-19th A.D.	Predominantly sea	Intensive interregional exchange; Europe, West Asia – India - South-East - East Asia. Europe still uncompetitive in relative terms, compensates deficit by silver bullion.
Fourth, contemporary	Sea; much less over land; air; telecommunications	Initially more from Europe to Asia; increasingly also in the opposite direction and within Eurasian land mass; significant boost as the Soviet Union broke up; huge boost with China rising as an economic superpower.

Table 9.3. Four Eurasian Exchanges

During the first exchange, the great facilitators and actors were the consolidated China under Han and the consolidated Roman Empire. The Roman Empire, for instance, was in contact with the most of Eurasia as far away as India and China. However, this nascent world system would not survive the end of the Roman Empire. According to Abu-Lughod, "... this was not a global or worldwide system..., it covered a significant proportion of the central land mass of Europe and Asia and contained most of the population that existed at that time, since the peripheral regions were only sparsely populated" (Abu-Lughod, 1989: 43).

It was a long time before the second Eurasian exchange materialized on the back China, India, and the Arab world. The maritime trade along the coast played the principal role.

Moreover, exchanges over the continental land mass became prominent at the time, visible in the history of the Silk Ways. There were three land routes of that time – Northern, Middle, and Southern ones. The Northern route across the landmass of Central Asia reached its peak as the Mongol empire settled for a relatively short timespan in the second half of the 13th century, and the traders could enjoy – not always and, of course, at a price – a relative security on the way from Mediterranean/Europe to China. The Middle route – connecting Mediterranean with the Indian Ocean via Baghdad, Basra, and the Persian Gulf – was presumably much more significant in terms of volume of trade. It is also true for the Southern route that went through Egypt and Red Sea to the Arabian Sea and then the Indian Ocean and was controlled by the Arab traders. To sum up, Central Asian trade over land should not be overestimated! According to Chaudhuri, even at its height, "the Central Asian caravan trade was complementary to the transcontinental maritime commerce of Eurasia" (Chaudhuri, 1985: 172).

Spencer observed an interesting characteristics of both maritime and overland trade in the 12-13th centuries, which he aptly summarised in one phrase: "Goods traveled farther than men". On their way from the point of departure to the point of destination goods changed hands many times, with each trader serving just one stretch. On this way, a handful of global entrepôts based on Molucca Straits as well as in the Islamic world (notably Cairo and Baghdad, but also Samarkand) became the verified world cities with distinct specialisation as trade cities. Few individuals traveled across the entire maritime route of trade, so goods indeed traveled farther than men[3]!

The Second exchange came to an end in the second half of the 14th century with the fall of the world system. Scientists clash over the causes of this phenomenon; however, the Black Death has certainly a lot to do with the disruption of trade connections and the terms of trade. For example, the population of Venice fell by three fifths. The land transportation was also ultimately disrupted by the break up of the pax mongolica.

In words of Abu-Lughod, "the unification of much of the central Eurasian land mass under the Mongols… facilitated the expansion of trade by opening up the northern route between China and the Black Sea outlet to the Mediterranean… [However,] its very success led ironically to its eventual demise… The unintended consequence of unification was the eruption of a pandemic that set back the development of a world system for some 150 years. When the system revived in the sixteenth century, it had taken on a quite different shape." (Abu-Lughod, 1989: 171).

Indeed, the impact of the Mongol empire on the world economy and trade – once the initial extremely negative effect of destroyed economies of Central Asia, West Asia, and Russia took place – is multi-faceted. On the one hand, the absence of borders from China to Europe facilitated the evolvement of the functioning overland trade route, which made a viable alternative to the Middle and Southern routes. On the other hand, among many things, it facilitated the creation of what can be called a 'common microbes market'. The rapid and unimpeded spread of endemics through the Mongol-dominated space clearly enabled the 14th century bubonic plague to move so fast through the Eurasian landmass.

The history of Exchanges/globalisation is intertwined with the history of endemics. This is quite natural, essentially because exchange of diseases forms an inherent part of a "shadow" side of the overall exchange. William McNeil suggests that by the start of the Christian era 'four divergent civilised disease pools had come into existence – China, India, the Middle East, and the Mediterranean (including Europe) – each of which contained a population of some 50-60 million people and had reached relative equilibrium with its environment, including endemic diseases. Their relative encapsulation from one another prevented the transfer from one system to the next of 'strange'

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[3] *George Spencer cited in Abu-Lughod (1989: 269).*

diseases (those for which local populations had not yet built up natural immunities of cultural patterns of avoidance and treatment)" (McNeill, 1976: 93-97).

Contrary to the second exchange the third one has already drawn in both Americas and virtually all of the African continent and, thus, became a global exchange. Despite its global character, it was still very heavily centered on Eurasia. Mutual exchange of goods, people, ideas and technologies (means of production, military, medicinal, agricultural etc.) across Eurasia to a large extent shaped the modern civilisation.

The story of rhubarb is illustrative of the routes and ways of influence in the Third exchange. Chinese rhubarb entered Europe through (1) Russian caravans traveling overland in the north or (2) through to Arabia or (3) by coastal trade routes. First, European pharmacists used it as a medication. Then, planting of rhubarb was attempted in Europe and in Russia, later in America. Starting 1970 the East India Company entered trade in a big way (Gunn, 2003:74).

Despite rising volumes of world trade, it should not be overestimated either. J.C. van Leur (1955: 212) estimates Southeast Asian trade in 15-16th centuries at 98,000 tons. The whole Asian maritime trade thus could be served by one contemporary supercargo container vessel employed over a year!

The current Eurasian exchange

To summarise, an important feature of the Eurasian exchanges is that they formed the heart of all world systems bar the current one (and even that is changing in a stunning rapid manner). The fourth Exchange has, however, taken a global scope. Eurasia forms a part of it, and its relative weight is growing due to rising Asia.

Johannes Linn calls Eurasia the "supercontinent" that underwent several waves of integration and disintegration when trade, population movements, and communication were flowing relatively freely, albeit slowly by today's standards, across the vast Eurasian space. The ancient Silk Road which spanned the continent East to West and North to South epitomises this time of economic connectedness. The interweaving tendencies of the 16th–19th centuries came to halt in the 20th century, notable for the establishment of the Iron and Bamboo Curtains, which separated the Soviet Empire and China from the rest of the world. "The opening up of China in the 1980s and the collapse of the Soviet Union in the early 1990s led to the opening up of previously closed borders and the transition from central planning to market economies. This ushered in a historic new phase of Eurasian development by permitting the integration of Eurasian economies with each other and with the rest of the world. This process of integration is now in full swing, connecting some of the largest and most dynamic economies of the world – China, India, Russia – with each other and with an expanding European Union." (Linn, Tiomkin, 2006).

The fourth Exchange differs from the previous ones on the base of sheer numbers. The major feature of the contemporary, fourth Eurasian exchange is that there are essentially new means of exchange, whose economic value may be difficult to measure directly against trade in goods, most importantly telecommunication and information exchange, but also air transportation (which greatly advanced the exchange of people and ideas). The technological advances in transportation and telecommunications helped intensify the global exchange by many–fold.

Another inherent feature of the fourth Exchange is that it will most likely result in a reestablishment of the "natural weight" of Asia both in Eurasia and in the world economy. The trickiest issue for research is not why Asia accelerates now but rather why it lagged and underdelivered in the 18-20th centuries.

Quality converts to quality, as the world gets much closer to each other, and previously isolated parts are drawn into the exchange of people, goods, services, information, ideas, and technologies. This, in turns, speeds up the pace of economic development to the levels not known before. Having said that, if the history of the human race teaches us anything, then that nothing is permanent. This Exchange can also come to end, be it because of a war, an endemic, or something else.

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10 Educational Migration from Kazakhstan to Russia as an Aspect of Strategic Cooperation Within the Customs Union

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This article is based on a study entitled "Educational Migration from Kazakhstan to Russia – one aspect of strategic cooperation within the Customs Union". The study examined current trends in educational migration from Kazakhstan to Russia. The project[1] was implemented in 2010, with the support from the EDB Technical Assistance Fund's programme for regional migration studying.

It was not a comparative study of educational migration flows from Kazakhstan to different countries, except where it analyses the students' reasons for choosing a particular foreign country for their education. The goal of the study was to identify the motivations for and possible future development of educational migration from Kazakhstan to Russia only. The analysis of educational migration tends to be very difficult – the relatively few studies that exist have been based on a relatively small research cohort, there are no points of direct comparison and there are many complex factors affecting each country's migration policy. However, it is still possible to identify key trends and tendencies. The findings and recommendations in this article apply only to educational migration from Kazakhstan to Russia.

Russian and Kazakh scholars have paid relatively scant attention to the issue of educational migration from Kazakhstan to Russia until now, for a variety of reasons:

- public agencies responsible for attracting foreign students do not have sufficient financial and human resources to implement such studies;

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- studies have tended to focus on the possible 'brain drain' effect upon the scientific potential of the two countries rather than on analysing the attractiveness of Russian educational institutions for Kazakh students and benefits of educational migrations. These issues are indirectly related to the international educational services market and do not provide an accurate overall picture, which is certainly a necessity if the existing resource base is to be used effectively.

Case studies of educational migration and the analysis of related processes carried out for Kazakhstan and Russia are still relatively rudimentary.

The interpretation of spatial interaction models by D. Harvey (1974) is important to any study of educational migration. According to Harvey, these models do not view linear measures in absolute terms in relation to human activity. Transportation costs are a more significant criterion for assessing the territorial availability of vocational training centres than their distribution by communication links.

We should also mention A.P. Katrovskiy's study, which examines the influence of political disintegration on the development of higher and secondary education in the post-Soviet space. The study highlights changes in the number and direction of travel of educational migrants, and focuses on educational migration within Russia (Katrovskiy, 1999). Given the rapidly changing situation in Russia, this study, which uses data collated in 1996, is now out of date. A more recent study was carried out in 2002 by Vitkovskaya. It is entitled *Immigrants in Regions of Russia: the Availability of Higher Education as a Factor of Adaptation and Social Stability*. It is only of oblique interest to the subject addressed in this article in that it analyses a particular aspect of educational migration, i.e., the integration into society of foreign migrants moving to Russia.

L.I. Ledeneva and E.V. Tyuryukanova conducted another study in 2002 and 2003. The methodology of the project, which focused on the Russian students studying abroad can be applied to Kazakh students at Russian universities. However, the analysis can only be applied selectively and in relation to different adaptation strategies.

The Ministry of Education and Science commissioned a new study from the Russian New University (Scientific Research, 2003). It identifies a need for a pro-active migration policy with regard to educational migration from CIS member states based on the similarity of their education systems and knowledge of the Russian language.

Two further studies are worthy of note: *Russian Universities on the International Educational Services Market* (Arefyev, 2007) and *The Scientific and Pedagogical Potential and Export of the Educational Services of Russian Universities* (Sheregi, Dmitryiev, Arefyev, 2002). The authors of these studies conducted an in-depth analysis of educational migration to Russia and compared Russia's experience with a foreign country. These studies closely resemble our own concept, but their conclusions are based on quantitative rather than qualitative analysis.

However, the material collected and analysed by the aforementioned authors in order to find answers to specific questions cannot be used to identify fully the opportunities that educational migration provides for Kazakh citizens moving to Russia, which is the suggested scope of our analysis.

This project aims to identify the problems and benefits of development of strategic cooperation between Kazakhstan and Russia by promoting educational migration and finding ways to strengthen relations between the Kazakh and Russian governments in the sphere of education.

In order to achieve this goal, the researchers structured their study as follows:

- a comprehensive analysis of social, economic and cultural incentives and disincentives for Kazakh citizens studying at Russian universities;
- development of recommendations for mutually beneficial cooperation in educational migration between Kazakhstan and Russia in the short-, medium- and long-term, which would help Kazakhstan enrich its workforce, assist in developing Russia's education system and encourage harmonisation of educational standards;
- suggestions of strategies to resolve, on an international level, issues such as educational migrants' safety.

Educational migration benefits Kazakhstan and Russia but it has not been included in the list of priorities for cooperation between the two states. Although educational migration is desirable for Kazakh school graduates, Kazakhstan's Bolashak[2] Programme and Russian universities, certain aspects of legislation in both countries hinder the creation of the necessary conditions and infrastructure which encourage it. Continuous assessment of educational migration, which we recommend in this paper, may help change this situation if the authorities act upon the issues that it identifies.

[2] The Bolashak international scholarship was established by the first President of Kazakhstan, Nursultan Nazarbayev, on November 5, 1993. The scholarship aims to: 1) educate Kazakh citizens in leading foreign universities on a full–time basis for them to attain a professional qualification or bachelor, masters or doctoral degrees, clinical residency training, and Ph.D. degrees in medical sciences, according to the list of priority disciplines applied to the scholarship; 2) organise traineeships for Kazakh researchers at leading universities, research centres and laboratories around the world according to the list of priority disciplines (http://www.edu–cip.kz/kz/).

It is appropriate to concentrate on educational migration flows from Kazakhstan to Russia: many Kazakh school graduates know the Russian language and are familiar with the Russian way of life and Russian traditions. They adapt to new environment much faster and more successfully than students from more distant foreign countries and students from other CIS countries. Moreover, the economic situation of Kazakhstan in recent years is likely to increase opportunities for Kazakhstani school graduates to move abroad to continue their education, particularly to Russia.

This study analyses available opportunities, the socio-economic impact and the prospects for international cooperation between Kazakhstan and Russia in training highly qualified personnel for Kazakhstan and encouraging conformity between the education systems in both countries.

Kazakhstan benefits from this cooperation by educating highly qualified specialists in Russian universities that are highly experienced in teaching many disciplines which are only just starting to be taught in Kazakhstan (qualified specialists are already in short supply in this growing economy). The state planned economy of the USSR had concentrated the best teaching personnel in the largest cities of the RSFSR. Even though Kazakhstan is progressively reducing the inequalities in its existing educational system, the country is still unable to provide the level of training required by Kazakhstan's economy.

Inward investment into Russia as a result of educational migration is not currently significant, although the potential of its scientific and educational complex is substantial. Attracting Kazakh school graduates does not only allow Russia to bring extra financial resources into the country; as they return home to Kazakhstan, the graduates of Russian universities bring with them a more tolerant attitude towards Russia, formed from their own personal experiences and relationships forged there. This has the strongest impact on intergovernmental relations and cooperation between the two countries. Because of Russia's aging population, the higher education system is already experiencing a dearth of applicants. It would therefore be more effective not to try and cut back Russia's existing scientific and educational potential, built up over many years, but to focus on attracting school graduates, undergraduates and postgraduates from Kazakhstan on a paid (contractual) basis. Kazakh students are the second largest contingent of overseas students in Russia (after students from China). Kazakhstan's adoption of the undergraduate, masters and doctoral degree system in 2010 and abolition of the traditional system of thesis-based degrees (candidate and doctoral) will increase the flow of researchers moving to Russia to defend their dissertations.

Russia's entry to the international educational services market depends on its ability to compete in terms of the quality of the services it currently provides, and on the rational expansion of educational migration flows, which Russia is currently neglecting.

The anti-immigration attitudes which have emerged in Russia in recent years, and the absence of any active promotion of educational migration from Kazakhstan, have persuaded many Kazakh school graduates to look towards western Europe and the USA in order to continue their education.

Research Methodology

The study was carried out simultaneously in Kazakhstan and Russia (Astana and Moscow) over six months and began by interviewing experts to gain an overview of educational migration from Kazakhstan to Russia. Experts' interviews were used to formulate theories, which were then tested by a series of in-depth surveys of Kazakh students in Russian universities and Kazakh citizens who graduated from Russian or RSFSR universities and now work in Kazakhstan.

A survey of 200 school graduates was carried out in Astana to find out what was influencing Kazakh would-be students in their choice of university.

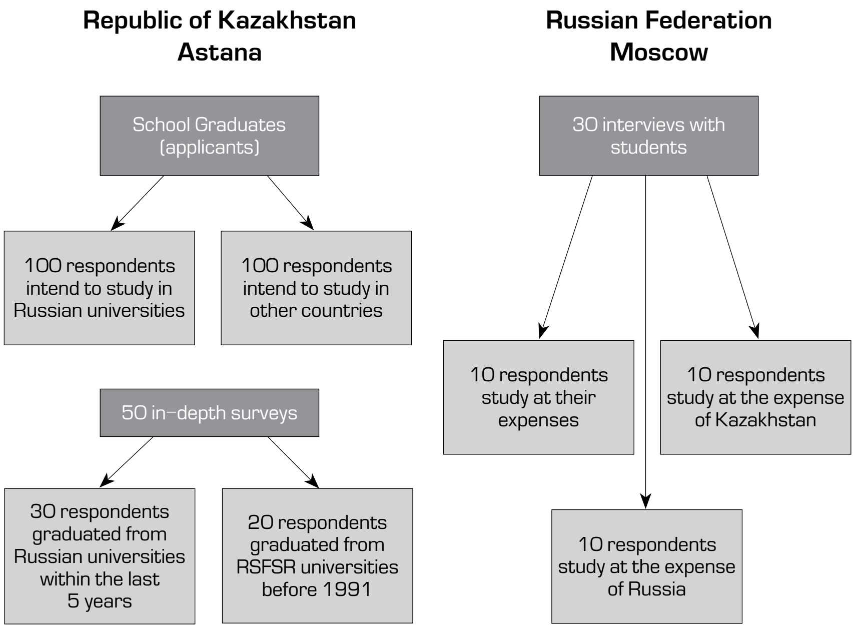

Figure 10.1. The structure of the study

Notes: experts – 15 respondents

The trends identified as a result of the interviews and the student survey has been complemented by an analysis of scientific literature and articles published in local mass media in the two regions under study (Astana and Moscow).

1. 30 interviewees were full-time students from Kazakhstan studying at Moscow universities. Half of the interviewees were young men, half young women. Of the 30 students, 10 are studying at their own expense, 10 are paid for by Kazakhstan and 10 are paid for by Russia.

2. 50 respondents were Kazakh citizens who had graduated from the Russian or RSFSR universities and who are currently living and working in Astana (Kazakhstan). Half of the interviewees were men, while half were women. Out of 50 respondents, 30 had graduated from Russian universities within the last 5 years and 20 had graduated from RSFSR universities before 1991.

3. The experts interviewed (15 in Astana and 15 in Moscow) included scholars, university personnel and administrative and ministerial officials whose work is directly linked to the educational migration of Kazakh students to Russia.

4. Out of 200 surveyed school graduates in Astana, 100 intend to study at Russian universities and another 100 intend to study in other countries. Half of the interviewees were young men, half were young women.

Results of the survey of Kazakh school graduates in Astana

According to the survey, Kazakh school graduates consider the UK, the USA, the Czech Republic, Turkey and Japan as the main alternatives to studying in Russia. The choice of country is determined by the availability of good universities (the main selection criterion both for those who intend to study in Russia and those who intend to continue their education in other countries). However, those who plan to study in Russia say culture is the second most important criterion ("an attractive place to live – lots of entertainment and interesting places"), advice from friends as the third and treatment of foreign students as the fourth most important selection criterion. Those who intend to continue their education in other countries put treatment of foreign students in second place when choosing their country of study. Safety is next ("it is safe to live here, no violence, no racism or mistreatment of migrants from other countries") and culture is again on the list of the most important selection criteria. We should mention that those who intend to study in Russia consider safety as one of the last on the list of important selection criteria.

Those who choose Russia as their country of study favour Moscow, Tomsk and St. Petersburg universities. Those who choose other countries prefer London, Prague and New York. When choosing the country of study, school graduates turn first to advice from relatives, friends and teachers and then the Internet. Radio, TV and newspapers are also used as information sources.

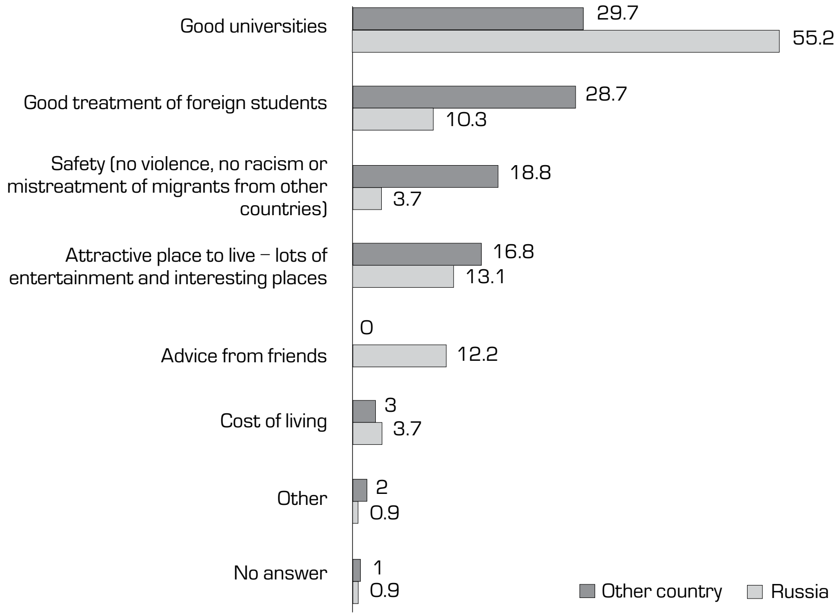

Figure 10.2.
Selection criteria for country of study (%)

The main reason for studying abroad for both groups of school graduates is simply their wish to study overseas. For those who choose Russia, their other reasons include (in descending order of importance) the higher cost of education in Kazakhstan, more competition for course entry in Kazakhstan and lack of opportunity to study their chosen subject. For those who choose other countries, their decision is based on the worldwide recognition of the university diploma of their country of study, more competition for that course in Kazakhstan and advice from parents or friends.

Those who choose to continue their studies in Russia seemed to have little knowledge of the Bolashak scholarship programme, while many of those who decide to study in other countries plan to take part in the programme.

Kazakh school graduates who plan to study abroad have a better knowledge of the Russian language and much better knowledge of English and other languages than those who intend to study in Russia. Those who choose Russia as their country of study may find it harder to secure employment in Kazakhstan once they graduate. For those who intend to study in another country, this is less of an issue, as is the possibility that their diploma will not be recognised in Kazakhstan.

Many of those wanting to study in Russia plan to settle there, while those who intend to study in other countries want to stay there only for a time. Those

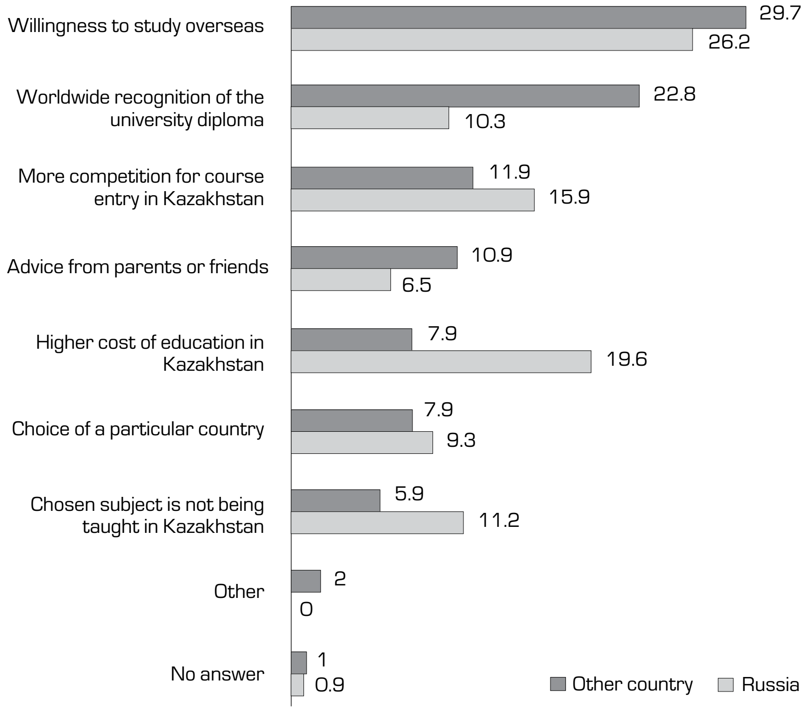

Figure 10.3. Kazakh school graduates' main reasons for choosing a particular country of study (%)

school graduates planning to study in Russia base their plans on the greater job opportunities there, or have relatives living there. For those who choose to study elsewhere, greater employment opportunities were a deciding factor, and also the better standard of living.

The majority of Kazakh school graduates intending to study in Russia had better school results and studied in ordinary secondary schools.

Ethnic Kazakhs account for around 90% of surveyed school graduates who choose to study abroad, and 35% of those who wish to study in Russia, while ethnic Russians account for 53% of this group of would-be students.

In summary, we found that Russia is the preferred country of study among school graduates who are less worried about practicalities, have more trust in their parents' opinion and are less informed about their educational opportunities. They are less interested in their potential standard of living as a student and have more explicit plans for their education, with the majority viewing their education in Russia as a step to settling there. The majority of those who would prefer to study abroad were keener to achieve higher earnings and to live more comfortably as students. They showed they were less influenced by the stereotypes that prevail in Kazakh society about studying in Russia. They aim to gain work experience abroad and intend to return to Kazakhstan at some point in the future.

Results of interviews with Russian experts

During the Soviet era, educational migration from foreign countries was concentrated in certain institutions (the largest centre being the Peoples' Friendship University of Russia) and pursued primarily geopolitical objectives. For the USSR as a whole, educational migration was a way of presenting a unified ethno-cultural image of this vast country, allowing the student to form a holistic view of a very diverse society. After completing their education, the graduate would return home with a world view shaped by living in the USSR. According to one of the experts interviewed, the Soviet Union used educational and all internal migration as a special "tool for cultivating a Soviet-style man".

Such measures proved to be effective; quotas were widely applied and very strict. University admission quotas were applied to poor or disabled students and students of different nationalities, including ethnic minority citizens of the Union Republics. Top Soviet universities, such as the Moscow State Institute for International Relations and the Moscow State University, were notorious for corrupt admission practices.

Since 1991, the situation has changed dramatically. In the years following the collapse of the Soviet Union, educational migrants from Kazakhstan to Russia were mostly Russians, i.e., children from Russian-speaking families keen to be educated in Russia. Interuniversity communications system as a whole has been upset, but still Kazakhstan was in a better position, since the state had more leading universities. Before Kazakhstan built up its national education system, the country fell significantly short of meeting educational needs, and school graduates continued their migration to Russia, especially because there were no significant restrictions, nor any legal or even cultural barriers. The situation is gradually changing and school graduates from Kazakhstan are now choosing to study elsewhere.

According to the Russian experts interviewed, any discussion of educational migration from Kazakhstan to Russia should take into account the following influences:

- Russia has not kept pace with other CIS countries (e.g., Ukraine and Belarus) that have drastically improved their national education systems and are now competing to attract foreign students from within the CIS;
- Russia has a reputation for xenophobia, racism and nationalism in general and particularly in relation to foreign students;

- Russian society fails to understand the differences between educational and labour migration;
- Russian universities are poorly equipped;
- there has been a lack of investment in the creation of integrated university campuses;
- there is a lack of employment opportunities for university graduates, including foreign ones;
- a regulatory framework needs to be established to allow students from Kazakhstan to take up placements and traineeships ;
- students have to acquire a special work permit so it is legal for them to find work in their spare time;
- education needs to be monitored for the value-for-money it represents;
- there should be support for enterprises that employ students, and for student businesses and innovative businesses;
- national educational migration policies are illogical and Kazakhstan and Russia have not been committed to this process.

Results of interviews with Kazakh experts

It is interesting to compare the opinions of Kazakh and Russian experts, since all of them identify the benefits of educational migration, especially for their own countries.

According to Kazakh experts, educational migration provided Kazakhstan's economy with skilled personnel both in the Soviet era and after the Soviet Union collapsed.

Since 1991, the situation has changed; nevertheless Russia continues to educate qualified professionals who cannot be taught in Kazakhstan either because Kazakh universities do not teach the relevant specialisation or because their training is of a lower quality than Russia's. Educational migration and Kazakh citizens moving to live in Russia helped strengthen the Kazakh diaspora in Russia by improving business links between Russian and Kazakh entrepreneurs. Kazakh populations in Moscow and st. Petersburg are the result of educational migration in the Soviet period (Rakisheva, 2007). Most of the Kazakh communities in the USA and Canada are made up of physicists, biologists, chemists, artists, pianists, historians and other experts from Russia who migrated before the collapse of the USSR (Rakisheva, 2011).

Kazakh and Russian experts agree that both countries have been somewhat complacent about educational migration. They point out that their ministries of Education and Science view the issue of educational migration only in terms of the fulfilment of quotas, and pay no attention to those who migrate independently of this system. This is despite the fact that those who travel abroad for their education under their own steam significantly outnumber those students who leave to study as part of a state-arranged programme. While recognising the positive impact of academic mobility (indeed, Kazakhstan advocates its own smooth transition into the Bologna process), Kazakhstan provides inadequate support for it.

Moreover, the practice of issuing dual diplomas (Russian and Kazakh), according to an international agreement, is poorly executed, although this practice is fully justified and effective.

According to Kazakh experts, the country bears no responsibility for employing Kazakh graduates with Russian diplomas or those who studied under the Bolashak programme. Many Kazakh citizens who graduated from Russian universities are forced to find jobs on their own without any state assistance.

Nostrification of diplomas (the acceptance of foreign university degrees as equivalent to native ones) is still a very complicated and lengthy procedure. Kazakh experts are concerned that a brain drain to Russia may result from inadequate state commitment to employing Kazakh educational migrants who are not part of the Bolashak programme.

The main obstacles to educational migration both in the Soviet era and now are the excessive centralisation and bureaucracy that surround the process, as well as the lack of autonomy of Soviet and Russian universities. Then and now, the universities have been ill-equipped technically and financially, and they have not invested in advanced laboratories and campuses which provide comfortable and secure accommodation for Kazakh citizens. The problems inherited from the Soviet era are changing for the better very slowly. Nevertheless, even top Russian universities are gradually losing their international reputation for the elite education they offer.

At present, the educational services Russia can offer to Kazakh students is rather limited, both in terms of the specialisations taught and the number of universities.

For Kazakh students, especially ethnic Kazakhs, there is quite a lengthy list of reasons not to choose to study in Russia: xenophobia is widespread, the police have a reputation for brutal behaviour towards immigrants, public safety is generally poor and Russian media encourage intolerance towards representatives of different nationalities. Anti-immigration attitudes therefore become a subtle characteristic of social behaviour and produce a negative image of the country. Kazakh students and their parents see the rise of skinheads as a sign that they are tacitly encouraged by the authorities, who are powerless against them.

It is perceived that there is a tendency to inflate the marks of Kazakh students in Russian universities, which undermines confidence in the quality of Russian higher education and acts as a disincentive to studying there.

According to the experts, democratisation of contemporary education is necessary for Kazakhstan, both on a societal and on an individual level, and the situation is not changing fast enough. These issues are largely ignored, however, and according to the experts this is the main reason that Kazakhstan faces such difficulty in restructuring its educational system.

The experts noted the absence of innovative technology in Kazakhstan's educational and scientific sectors, the gap between theory and practice in supporting educational migration, and lack of incentives for business and industry to sponsor overseas education. There are still no opportunities to develop or test alternatives to the ways in which educational migration is currently organised, or to make effective use of the knowledge gained by Kazakh citizens while studying abroad. This situation can only change with government intervention, and particularly with state financial support. Students who studied in Russia do not go on to become scientific leaders, and the academic mobility of students and teachers in Kazakhstan's universities is not being encouraged. The majority of middle-aged teachers, and those working beyond retirement age, do not speak conversational English but have a good command of Russian and could therefore travel to Russia for retraining courses. However, Russia has no effective short-term teaching resources to train Kazakh teachers in innovative and interactive educational technologies.

The experts also pointed out corruption in Kazakh universities, which is an additional impetus to students to move to Russia and other countries to study.

According to experts, very little is being done to attract private investment in education. For example, tax incentives could be offered to organisations, businesses structures and individuals that provide sponsorships or make charitable donations to educational institutions. This would lift part of the state's financial burden in supporting education in Kazakhstan.

Kazakhstan had introduced a system of academic credits based on the American model, but soon afterwards the country joined the Bologna process. This forces Kazakhstan to implement the European Credit Transfer and Accumulation System (ECTS). Now, experts say, Kazakhstan needs to choose which system it wants – a credit system or ECTS.

Councils of trustees are considered to be a step forward in the democratisation of university management. The councils are public advisory bodies that help to attract additional funding and oversee the activities of the university, but they have not yet been set up. Certain universities have alumni associations, but so far these have only acted as social groups, and are not used as a means to provide additional support to Kazakhstan's universities.

Russia and Kazakhstan have responded poorly to the globalisation of education and are slow in implementing innovative learning techniques; distance learning, for example, is still barely developed.

It is clear that Russia's manufacturing and scientific infrastructure requires significant government investment to ensure Russian universities attractiveness to foreign students. However, educational migration is hindered by the structural obstacles which exist in Kazakhstan, as mentioned above. Professionals are in demand in Kazakhstan and experts note that it is an achievement in itself that professional education in Russia is universally regarded as being of very high quality.

Kazakh school graduates opting to study in Russia traditionally prefer the universities of Moscow and St. Petersburg, cities closer to the border of Kazakhstan (Novosibirsk, Omsk, Barnaul, Tomsk, Samara) and universities in the Volga region. The experts said that Kazakh citizens who are ethnic Russians use education in Russia as an opportunity to leave Kazakhstan. Ethnic Kazakhs are often interested in, among other things, the relationship between local authorities and the Kazakh diaspora, and the availability of Kazakh cultural centres in the cities where they plan to study. The presence of such centres and good relations between local authorities and Kazakh people tends to make a city more attractive to ethnic Kazakh prospective students and makes their adaptation to the city easier.

Kazakh citizens who successfully graduate from Russian universities are the best propaganda tool for Kazakh school graduates, therefore it would benefit Russian universities to set up branches of their alumni associations in Kazakhstan. The experts also believe that setting up "sister universities" in Russia and Kazakhstan would be very effective. This could be complemented by creating agency services headed by Kazakh alumni of Russian universities (or postgraduate/doctoral students). Establishing an agency network via such service centres, especially in border areas, Astana and Almaty, would also be a good step forward.

The way in which the community runs educational institutions in the Republic of Kazakhstan has, unfortunately, changed very little. Modern managers need a skill set which they do not always possess, including the ability to rationally assess risk in their management decisions, knowledge of the organisation's development, its strengths and weaknesses, its traditions, the conservatism of the teaching staff, comprehensive knowledge of the university's activities, the ability to respond rapidly to change and to think strategically. Partly because of the high turnover of staff in educational management, i.e., among faculty leaders, many are not keen to engage in international cooperation, which, in the opinion of the experts interviewed, is the major stumbling block to enhancing educational migration in the Russian Federation.

Therefore, summing up the opinions of Kazakh experts, we can say that the most important strategy in developing educational migration from Kazakhstan to Russia is govermental support and the return of specialists trained in Russia to Kazakhstan.

Results of the survey of Kazakh students studying in Russia and Kazakh citizens who have graduated from Russian and RSFSR universities

Survey of Kazakh students studying in Russia

Most of those who took part in the survey are satisfied with the education they received in Russia and would recommend it to their friends. However, it is clear that the consistent and progressive development of educational migration is dependent on the resolution of certain problems. It is important to note that, because the survey group was small, it is impossible to attempt a ‘ranking’ of the issues identified. But the responses allow us to identify certain problematic situations and shortcomings.

Kazakh school graduates choosing to study in Russia do so because they historically have had a positive image of Russian universities as well as because there is no language barrier. The choice of a particular city usually depends on the student’s personal views or advice they have been given by relatives and friends. How a university is rated in internet reviews is also important. The final choice of Russian university will depend on its image and, more importantly, a comparison of the accommodation that is on offer. Incomplete (or withheld?) information on lifestyle and accommodation at the selected university is a particular problem for prospective students.

Other serious weaknesses which respondents criticised include poor technical procedures in universities, and the inadequacy of university support structures and technical staff .

One way to try and prepare students would be provision of adaptation courses in Kazakhstan or various types of training before students leave to take up their courses. Students have even agreed that they themselves could bear the cost. However, acclimatisation courses are so clearly in the interests of the universities and the Russian Ministry of Education they should be free for the students. Bolashak programme staff have often provided pastoral assistance to students finding it difficult to adapt. This extends to students arriving independently or through other programmes, not just to

Bolashak students. There have certainly been cases of employees of Russian educational institutions helping students resolve their problems.

During the first days and months of studying in Russia, psychological pressures can take their toll. Careful planning of admission procedures could help alleviate certain problems. Some new students will benefit from having access to counseling or psychological therapy. The Internet is an important learning resource, but unfortunately it is not always free for students.

Constant changes in teaching methods relating to the introduction of computers did provoke a number of complaints from respondents (poor content and design of Russian universities' websites). Climate is beyond the control of any institution, but does have a bearing on accommodation. Being housed in a poorly heated room in a cold winter can be a very serious problem. The majority of complaints concerned living conditions. The excessive commercialisation of universities also has a negative influence on their image.

Unfortunately, latent and even overt xenophobia is a widespread phenomenon not only among the local population but also among teachers, and this again detracts significantly from the positive image of Russian universities.

Kazakh students have serious and well-founded complaints against the police, who often mistake male students for migrant workers.

In many respects the quality and format of teaching, and the cost-benefit ratio, meet the expectations of Kazakh students.

Even those Kazakh students who are not satisfied with the quality of Russian education feel that they would have no difficulty finding a job in Kazakhstan because of the good reputation Russian educational standards have in Kazakhstan. However, lack of fluency in the Kazakh language might be a serious obstacle to employment which could have been avoided had they chosen to study at a Kazakh university. Students may also find that there are not many jobs requiring the professional qualifications they acquired in Russia, or find that corruption in Kazakhstan restricts the type of jobs that are available on the open market.

By socialising with other students from Kazakhstan when they arrive in Russia, Kazakh students usually overcome the problems of adapting to their new surroundings. Some ethnic Kazakhs adopt a strategy of mixing with foreigners from countries much further afield, to gain an entirely new social circle and new perspectives. The various cultural activities universities offer actively encourage this process. However universities often provide limited opportunities for leisure activities and most of these are on a fee-paying basis.

Students believe that finding a job will not seriously interfere with their studies, and consider the opportunity to work as a way of obtaining the practical skills required in the profession they are studying towards. If they are prevented from working legally, students can sometimes find that they fall victim to fraudulent employers, are badly paid or are forced to put up with very poor working conditions. As mentioned above, despite all the difficulties, the majority of students surveyed would advise their friends to study in Russia. Of course, for some Kazakh citizens of Russian descent, studying in Russia can be their stepping stone to settling there and is the reason they recommend this path to their friends.

As the students' responses show, there are problems in Russian universities and almost all of them can be resolved or mitigated by the universities themselves. However, while some universities are keen to address these issues, others are not.

The current situation could be improved by standardising the requirements that universities must meet when they aim to recruit foreign students. The amount that universities are allowed to charge for their courses could depend on their level of compliance with these requirements.

Survey of Kazakh citizens who graduated from Russian and RSFSR universities

By conducting a survey of Kazakh citizens who graduated either from Russian or RSFSR universities, we were able to identify changes in the education of Kazakh citizens in Russia in the Soviet era and the post-Soviet period.

As a rule, university education in the USSR was based on a special distribution system and social quotas. Courses were offered by the leading universities of the RSFSR and included disciplines that were not taught in Kazakhstan.

The image of Russian universities was positive in Soviet times and information about universities was widely available. Indeed, Moscow was very attractive as a cultural centre.

For students in Soviet and post-Soviet periods, the difficulties they faced were generally associated with the higher requirements of Russian universities. For those who studied in the last five years, everyday problems were the most significant, though socialising with their compatriots usually helped them to adapt.

The problem of xenophobia either did not exist in the Soviet era or had no overt signs. One of the respondents who studied in the last five years claimed that some Kazakh students use xenophobia as an excuse for failing their courses. However, xenophobia obviously does exist in modern Russia. Some of the students surveyed also mentioned cases of somewhat brutal treatment at the hands of the police.

Those who studied in the Soviet era were unanimous in evaluating their educational experience positively. Kazakhs who studied in the Soviet era had to take a difficult matriculation examination, which is why the overall level of attainment of those who studied in the RSFSR was very high.

Living conditions in the Soviet era gave Kazakh students little cause for complaint: standards of living were mostly relatively poor in the USSR, although student dormitories were maintained much better than they are now. Because student dormitories have always been central to the student way of life, some of their worse aspects were overlooked.

Those who studied in the last five years voiced more complaints about living conditions because socio-economic conditions in Kazakhstan have changed and alternatives to studying in Russia have emerged.

Views of the quality and cost of education expressed by those who had studied in the past five years in elite universities were mainly positive with some neutral and very few negative comments.

The Soviet diploma awarded by RSFSR universities was a hallmark of quality and guarantee of a good start in life for Kazakh graduates during Soviet times. For those who studied in the last five years, the Russian diploma is an advantage but not a one-hundred-percent guarantee of finding a job.

In Soviet times a scholarship was enough for postgraduates to live on, but students needed extra financial help from their parents. But students of course made some money on the side in the RSFSR as well. Among those who had studied in the last five years, the attitude towards extra earnings is different and being allowed to work legally is an important issue for students from Kazakhstan.

It is important to note that the majority of Kazakh citizens who wanted to stay in the USSR, no longer live in Kazakhstan. Therefore, the survey mostly reflects the views of those who initially planned to return to Kazakhstan and now in many cases see their return to Kazakhstan as an expression of patriotism. Those who studied within the past five years demonstrate various motivations for their migration and their decision is not always an unambivalent one.

The image of Russian education has changed significantly over time. This clearly reflects the dramatic changes that have occurred since the collapse of the Soviet Union and changes in economic conditions in Kazakhstan over the last five or so years.

The prestigious image of a Russian university education remains from Soviet times, and leading Russian universities do still offer teaching of a very high standard. But the pressure on other institutions to improve the quality of their educational experience is increasing and higher education in Russia generally clearly needs to be reformed if it is to retain its desirable image in the eyes of Kazakh students.

Short–, medium– and long–term strategies to encourage educational migration from Kazakhstan to Russia

Short-term measures:

- find a way to support universities willing to increase their admission of foreign students; build new campuses and dormitories or refurbish and modernise existing ones;
- develop existing scientific institutions by equipping them with modern technology. This will help strengthen the reputation of Russia as an educational powerhouse;
- develop institutions regionally. Support and modernise metropolitan universities and higher education institutions in Russia's far east (Krasnoyarsk, Novosibirsk, Tomsk and Irkutsk).

It is obvious that these measures will require a degree of political will and are not just a matter of state funding or co-financing.

Medium-term measures

Specialist secondary technical schools, vocational schools and colleges should be created which will help to attract foreign and Russian students.

Secondary vocational education is very important strategically and should be developed in parallel with higher education. Universities that do not meet required higher education standards could be transformed into secondary vocational colleges.

In the medium to long term, there should be a policy of boosting the image of blue-collar occupations. This is an enormous task given that, even in Soviet times, the policy only succeeded with a great deal of difficulty.

The Russian belief that any type of work is worthy of honour needs to be modified. Again, since this can only be achieved in the long term, any near-term initiatives must be closely linked with educational and labour migration policies. A 10-year educational migration programme should incorporate migration to secondary specialised educational institutions. The export of educational services should be a multi-layered initiative. Educational migration from Kazakhstan (and elsewhere) to Russian universities is a way of promoting Russian education, gradually increasing its quality and attracting more students from abroad to Russia's specialised secondary educational establishments. This engages those who will later work in Russian factories.

Promoting the quality of education provided by universities in the Russian Federation should have a "domino effect" in regard to the export of Russia's educational system as a whole. By educating young people from other countries and improving its institutions Russia also provides work for its teachers.

Measures to enhance educational migration need to be focused on higher education students from Kazakhstan who intend to go back to their native country once they have completed their education. As graduates return to Kazakhstan, they forge links between the two countries, which cannot be replicated by any political agreement between Russia and Kazakhstan. They also return to Kazakhstan equipped with in-depth knowledge of the special characteristics of the Russian educational system, and, assuming they are happy with and give good account of their education, will encourage a new influx of Kazakh school graduates into Russian universities. If Russia is to maintain the high quality and good image of its educational system, a steady stream of Kazakh school graduates into Russian universities could be boosted with a second flow of educational migrants to its secondary education institutions (not necessarily from Kazakhstan). This will help attract school graduates from around the CIS, who will have the opportunity to stay on and work in Russian industrial enterprises (which face an acute shortage of workers) after they complete their education in Russia's specialised secondary schools. To secure the inflow of educational migrants from the CIS into the secondary education system, Russia must consider changing its legislation, since 15–year-old college students are considered as children. New laws are required to allow underage foreign citizens to stay in Russia.

Any comprehensive, medium-term (ten-year) programme must include regulatory changes, development planning, research, approbation, and several well-targeted studies (e.g., a study of international practices and region-by-region reviews of the policy implementation). An effective federal policy on educational migration must resist the temptation to adopt new laws once the policy has been implemented – i.e., avoid the process of "filling in holes" in existing legislation.

Russia is not in a position at the moment to implement this legislation, and therefore all initiatives to develop educational migration remain on hold.

Long-term goals

Long-term objectives include the establishment of required educational policies alongside the creation of a tolerant society and socio-cultural cohesion. Encouraging an attitude of respect towards migrant workers can be achieved in part through the work of students on campuses in particular, which is one of the long-term goals related to educational migration.

The following measures may help to encourage educational migration to Russia from Kazakhstan:

- investment in the scientific and technical infrastructure of Russia's educational system;
- the simplification of Russian registration procedures and the elimination of unnecessary bureaucracy;
- the legalisation of employment for Kazakh students, especially during holiday periods;
- international agreement with Kazakhstan to simplify nostrification procedures, and mutual recognition of university diplomas by Russia and Kazakhstan to make postgraduate training and masters courses in Russian universities more accessible to Kazakh citizens;
- government measures to promote greater tolerance of Kazakh students in Russia, using a media campaign in Russia to counteract racism and intolerance towards immigrants;
- a clean up of the police force, removing officers who extort bribes from Kazakh students when verifying documents;
- taking a hard line with criminal skinhead gangs (particularly Nazi skinheads[3]) and similar anti-immigrant groups;
- establishing a tolerant learning environment that eliminates racism towards students from Kazakhstan on the part of Russian students, teaching staff and administrators in educational institutions;
- actively involving Kazakh students in social and cultural activities at university and in Russian student hostels and allowing students from Kazakhstan to travel around the Russian Federation (freedoms that other countries extend to foreign students);
- building and refurbishing dormitories to offer car parking facilities and free access to the internet for all students. Small specialised universities could be allowed to rent a small number of places in large university campuses;
- the Ministry of Education and Science should create an innovative internet-based information system, which would provide a single source of information on public and private higher education institutions. The information must be detailed, clear, multilingual and free;

[3] *National Socialist skinheads (or Nazi skinheads) – radical nationalists and racists, who adhere to National Socialist ideology, advocate the idea of race separatism and White Power supremacy, cultivate violence, idealise the Third Reich and collaborationists. The activities of National Socialist skinheads are extremist and in many cases of a terrorist nature.*

- creating a grant system to support talented school graduates from Kazakhstan, including full reimbursement of all costs;
- introducing a programme of support for students from Kazakhstan and Russia to find their compatriots abroad; private Russian charity foundations could be involved in setting up pastoral organisations which would use the higher education system as a way of strengthening international relations and supporting expatriates;
- establishing alumni associations for USSR and Russian universities in Kazakhstan[4] using them to support the activities of Russian higher education institutions in Kazakhstan and to strengthen cultural and scientific relations;
- creating cultural, educational and job exchange programmes similar to those which exist in Germany, Britain, Australia and the USA. These would promote Russian education and Russian culture in Kazakhstan and attract individuals and organisations to participate in such programmes;
- promotional activities in Kazakhstan, via the Russian Embassy and cultural institutions (participating and organising educational exhibitions, creating a network of coordinators responsible for educational issues who would disseminate information on Russian educational opportunities to Kazakh school graduates). Existing expatriate associations abroad should be linked together[5];
- restoring Russian language teaching in Kazakhstan and news broadcasting in Kazakh on Russia's national radio stations and TV channels (with the focus on cultural and music programmes for youth).

There is potential to expand educational migration from Kazakhstan to Russia, facilitated by the shared border, common history and culture, and the establishment of the Customs Union. The education ministries in both countries, their migration and integration agencies can also help promote educational migration.

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[4] Participants at the Second World Forum of Foreign Alumni of Russian Universities in Moscow made a similar appeal. October 3, 2007. http://www.embrus.org.ua/modules.php?op=modload&name=News&file=article&sid=695&mode=thread&order=0&thold=0&POSTNUKESID=171beb42d497a8a0.

[5] Such events are regularly held overseas under the auspices of the Federal Agency for the Commonwealth of Independent States, Compatriots Living Abroad and International Humanitarian Cooperation (Rossotrudnichestvo), but they are very small scale. http://www.rusintercenter.ru/?lang=ru&menu=115.

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11 Integration Processes in CIS Telecommunications Sector

Aigul Absametova

The purpose of this article is to provide an insight into integration processes in the CIS telecommunications sector, the prospects for telecom companies as potential targets for investment, the region's transit potential, and integration of CIS countries into the regional and global information community. The authors focus on the current status of telecommunications in the CIS, existing investment opportunities, cross-border investments, and major players in the mobile communications. The article is based on the EDB sector report no. 9 "Integration Processes in CIS Telecommunications Sector".

Introduction

Globalisation of world economy and the increasing transparency of national borders elevated the role of information to a new level. Information can provide critical advantages to an individual company, country or the entire region. The possession of a competitive telecommunications sector is a precondition to a nation's entry into the global economic and information community.

The telecommunications market consists of a number of distinct service segments based on the following telecommunications types: fixed-line telephony; mobile communications; data transfer (Internet access); satellite communications. According to the International Telecommunications Union (ITU), by the end of 2009 over 4.6 billion people (about 67% of the world population) used mobile communications, and Internet users accounted for 26% of the world population (1.7 billion people). Fixed-line telephony already lags behind mobile communications (23% of the world population or 640 million people) (ITU, 2009).

This trend is also observed in the post-Soviet states. The last decade saw a telecommunications boom, and the level of penetration of fixed-line, mobile and Internet services was especially high in Russia, Kazakhstan and Ukraine: according to the ITU, by the end of 2008 there were 314 million users of mobile communications, 72 million users of fixed-line telephony, 69 million Internet users in CIS countries (see Figure 11.1).

The CIS is one of the most dynamic mobile communications markets with an average annual growth of 44% (in 2003-2008). Penetration of mobile communications services increased from 17.9% in 2003 to 113% in 2008.

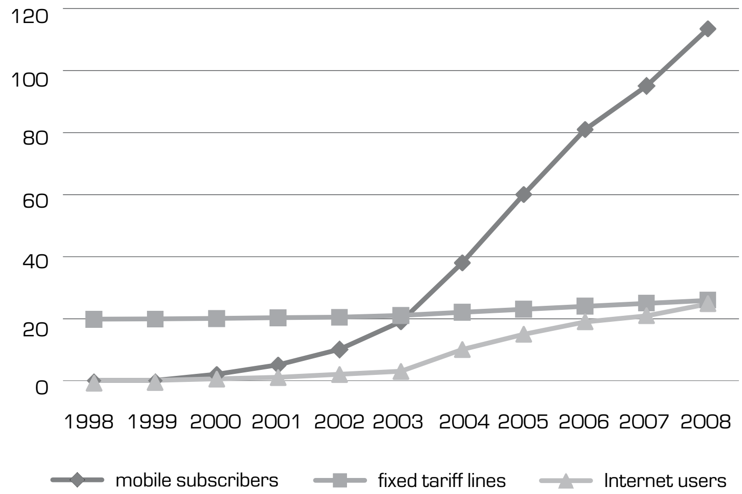

Figure 11.1. Development of information and telecommunications technology in CIS, 1998–2008

Source: ITU, 2009

This rapid development can be partially explained by increasing competition between market players.

ICT development levels vary greatly across the CIS. In Russia and Ukraine the penetration of mobile communications services is approaching 120%, whilst in Turkmenistan this index does not exceed 10%. The attractive targets for investment may be Turkmenistan and Uzbekistan, which have the lowest penetration levels in the region. Growth rates in the CIS during 2002-2007 averaged at 60%, which is a fairly high figure compared with other world regions. The main reasons for this rapid growth are the underdeveloped fixed line networks and increasing competition on the telecommunications market (ITU, 2009). A notable increase in the number of mobile communications subscribers during 2000-2005 was achieved principally by the introduction of the second generation 2G and 2.5G networks based on GSM technology.

Investments in CIS telecommunication market

Investments are critical to the development of any market, and telecommunications is no exception. In recent years there has been some increase in investments in ICT in CIS (see Table 11.1), notably in mobile infrastructure and broadband Internet access. However, the latter remains quite expensive and largely inaccessible in rural and remote areas. According to the World Bank, there was a sustained upward trend in investments in the CIS telecommunications market until 2007, including private sector investments.

One of the ways to attract foreign capital is to privatise state telecom assets, because privatisation could open the monopolised fixed-line market

Table 11.1. Investments in CIS telecommunications market ($ millions)
Source: Absametova et.al., 2010

Country	2004	2005	2006	2007	2008
Armenia	61.7	132	0	104	110.6
Azerbaijan	109	123	413.6	188	474
Belarus	148	187.6	220.4	660.9	1130
Kazakhstan	275.7	484.5	635.2	838	1146.6
Kyrgyzstan	0.6	0.6	35.9	5	75
Moldova	9.6	36.5	34	163.3	81
Russia	5952.3	5906.3	6397	6586.1	7692
Tajikistan	n/a	n/a	n/a	11	53
Turkmenistan	383.8	7328.9	1991.7	2215	3954
Ukraine	738	1407.3	865.2	1345.8	1363.8
Uzbekistan	3	93	90	272.1	318.8
Total	7681.7	15699.7	10683	12389.2	16080

of the CIS to private investors. At present the telecom companies are co-owned by governments in all post-Soviet countries except Armenia. Some countries have already made the first steps towards the privatisation of these assets.

The Kazakh operator Kazakhtelecom was the first state-owned company to offer its shares for sale. 51% of its shares are now held by the government via Samruk-Kazyna and 49% by private investors (Kazakhtelecom, 2010). The controlling stake (51.3%) of Azerbaijan's leading operator, Azercell Telekom, is held by Azertel Telekommunikasyon Yatirim Dis Ticaret A.S., a subsidiary of Fintur Holdings B.V. All telecom assets in Armenia are in private ownership. In 2007 the country's main operator, ArmenTel Joint Venture, was sold to VimpelCom for $540 million, $52 million of which was paid to the government for its 10% stake.

The telecom companies of the eight post-Soviet states remain unprivatised. Whereas in Kyrgyzstan and Ukraine the sale of state assets is highly possible (the shares of telecom companies have been offered for sale), in other countries this process is likely to take many years. The last attempt at privatising Kyrgyztelecom was inconclusive due to the change of government in April 2010. This prospective transaction attracted interest from Turk Telekommunikasyon A.S. (Turkey), Axos Capital GmbH (Germany), Kazakhtelecom and Rostelecom.

The privatisation of the Ukrainian monopolist Ukrtelecom has long been the subject of speculation, but so far the controlling stake (92.79%) is held by the government. It is expected that the company will be offered for open bid at an initial 7 billion hryvnias (about $882 million). The prospective bidders are Rostelecom, SKM, Deutsche Telekom, Telenor Group, Turkcell, Roman

Abramovich’s companies, Privat Group, Telekom Austria, Sistema Financial Corporation, VimpelCom, Bank of New York, UBS, Namura and others (Karpenko, 2010).

The privatisation of Uzbektelecom has lingered for a decade. The last attempt to sell a 49% stake was made in 2004, with participation of Golden Telecom, Sistema and China Mobile Communications Corporation as bidders. However the company is still owned by the government.

A similar situation can be observed in Belarus and Russia. In November 2009 the Belarusian Ministry of Telecommunications and Information Technology once again postponed privatization of Beltelcom for at least two years. In it’s turn, the reorganisation of Russia’s Svyazinvest foresees the establishment of a single operator on the basis of Rostelecom (51% is owned by Svyazinvest, 30% by the Agency of Deposits Protection, 9.8% by Vneshekonombank, and about 10% of common stock and 100% of preferred stock is freely circulated) (Rostelecom, 2010).

A key point in the Svyazinvest reorganisation concept was an establishment of an alliance with one of the “big three” operators (MTS, VimpelCom or MegaFon), but no such plans are being discussed at present (Sergina, Bursak, 2010).

The privatisation of the Tajik operator Tochiktelecom have began in 2003, when the company was included in the government’s strategic privatisation plan. However, there has been little progress so far. Kazakhtelecom has indicated its interest in bidding in case the Tajik operator will be offered for sale. As for Turkmenistan, no intention to privatise Turkmentelecom has ever been voiced (Shepovalnikov, 2009).

Country	Assets	Package (%)	Estimated value ($ million)
Ukraine	Ukrtelecom	67.79	882
Moldova	Moldtelecom	51	223.7
Kazakhstan	Kazakhtelecom	27	178.2
Uzbekistan	Uzbektelecom	49	115.3
Kyrgyzstan	Kyrgyztelecom	77.84	78.1
Azerbaijan	AzEuroTel Telecom-munications,	50	n/i
	Ulduz Telecom	28	n/i

Table 11.2. State telecom assets to be sold

Source: Shepovalnikov, 2009

Note: n/i – no information

Another efficient strategy for attracting capital to the sector is to promote an alliance between the government and private companies (e.g., on the principles of private-public partnership). The benefit of private-public partnership is that the government retains control over the sector while considerably easing the burden on the state budget by involving external investors. In our view, private-public partnership schemes deserve more attention in the context of the telecommunications sector, but their success will depend on the availability of an adequate legal framework.

We do not expect any large privatisation transactions in CIS countries during 2010-2011. The operators' activity is likely to be limited to individual investment projects to develop networks and new services. Subject to the success of these projects, the investors will be better positioned to claim larger stakes in privatised telecom assets, although we will not see the likes of the large-scale transactions of the past decade again.

Mutual investments in telecommunication by CIS countries

From the early 2000s the Russian telecommunications market was characterised by high levels of penetration of most services, which can be explained by the large population and relatively developed infrastructure. Foreign capital also played a role in this rapid growth. For example, the leading Russian operators MTS and MegaFon were co-founded by Deutsche Telecom, Siemens and TeliaSonera.

Although the domestic market was not yet fully saturated, Russian operators started to seek new opportunities for expansion. The markets of neighboring countries which have close political and economic ties with Russia appeared to be ideal targets. The post-Soviet countries had much in common: high growth rates, relatively low basic penetration levels, and a similar business environment.

Another incentive for Russian mobile operators to penetrate post-Soviet markets is associated with the so-called "follow your client" strategy. Many corporate clients from different economic sectors are already integrated with foreign market players (Lisitsyn et al., 2005). For example, LUKoil participates in the development of oil deposits in Kazakhstan, Uzbekistan and Ukraine and sells hydrocarbons all over the CIS. LUKoil and other corporate clients of mobile operators need sustained communications with their overseas branches.

In an effort to expand their subscriber base and better serve the customers' needs, Russian operators started to penetrate international telecommunications markets in 2000 and made first steps towards a common CIS market. Merger and acquisition (M&A) deals became the key element of the penetration strategy. This practice is very popular in telecommunications as it foresees the use of the existing infrastructure and a subscriber base of the operator being purchased. At present, major Russian mobile operators, including Mobile TeleSystems (MTS), VimpelCom (under the Beeline trademark) and MegaFon have established their presence in all CIS countries (see Figures 11.2. and Table 11.3).

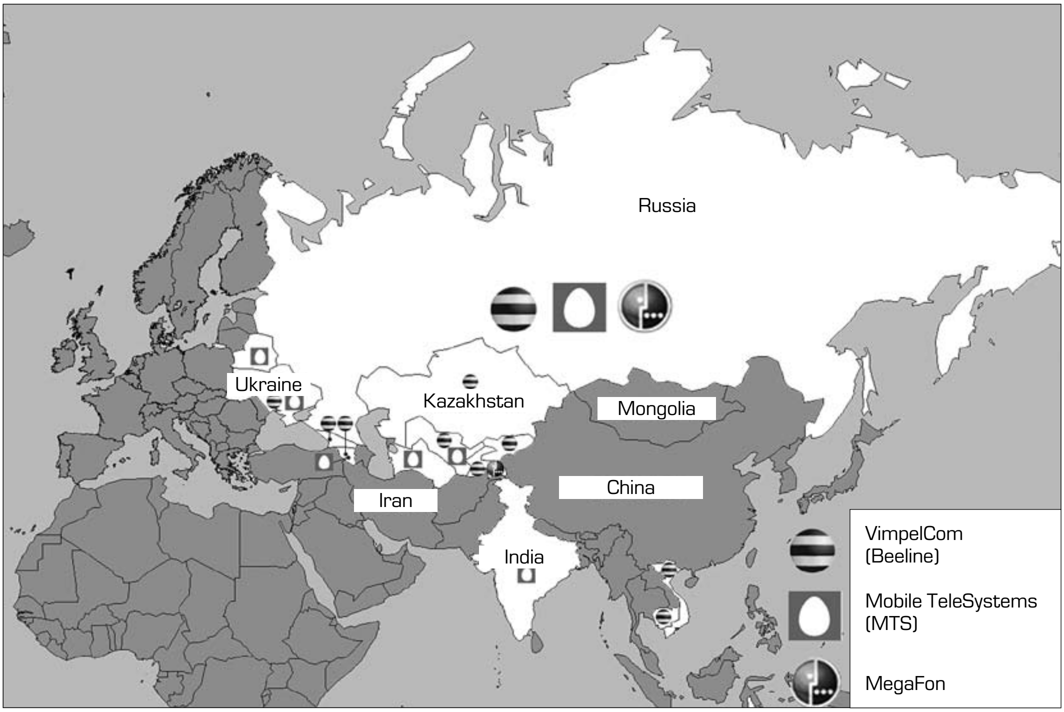

Figure 11.2. Service area of Russian mobile operators
Source: Absametova et.al., 2010

As of April 2010, VimpelCom took the lead in terms of increase of subscriber base geography. Its affiliate under the Beeline trademark offers mobile and fixed-line services and high-speed wireless and broadband Internet access in Russia, Kazakhstan, Uzbekistan, Ukraine, Tajikistan, Georgia, Armenia, Vietnam and Cambodia (since 2008) (Beeline, 2010).

Mobile TeleSystems has over 85 million subscribers in Russia, Armenia, Belarus, Ukraine, Uzbekistan and Turkmenistan (MTS, 2010).

MegaFon has the most narrow business geography among the "big three" Russian mobile operators. The company operates in Tajikistan, where owns a 75% stake in local TT-Mobile operator. However, MegaFon does intend to cover more overseas markets. According to its General Director Sergei Soldatenkov, the company is not interested in Ukraine or Belarus because of tough market competition. Georgia, Kazakhstan, Azerbaijan and Moldova are all dominated by Fintur Holdings B.V. (a joint venture of TeliaSonera and Turkcell). Therefore, MegaFon's targets are Armenia, Kyrgyzstan and Uzbekistan, the least penetrated markets (Kepman, 2010).

Another prominent player in the Russian and CIS markets is Altimo (by 2005 known as Alfa Telecom), a member of Alfa Group. Altimo is an international investment telecommunications company which has stakes in MegaFon (25.1%), VimpelCom (44%), Kiyevstar G.S.M. (43.5%) and Turkcell Iletisim Hizmetleri A.S. (4.99%) The latter operates in Ukraine, Georgia, Moldova, Kazakhstan, Azerbaijan and other countries through its joint venture Fintur. In 2009 Altimo's market capitalisation exceeded $16 billion (Altimo, 2010).

Operator	Year	Country	Transaction price ($ million)	CAPEX ($ million)	Stake (%)	Description of transaction
MegaFon	2001	Tajikistan	joint venture		75	Joint venture with Tajiktelecom, using the TT-Mobile brand
MTS	2002	Belarus	joint venture	40.26	49	Co-founded with Beltelecom and MTS
MTS	2003	Ukraine	373	2 974.5	100	Purchased Ukraine's leader, UMC
VimpelCom	2004	Kazakhstan	350	518.64	100	Purchased Kazakhstan's second largest operator, KaR-Tel. VimpelCom assumed liabilities of $75 million
MTS	2004	Uzbekistan	121	739.4	100	Purchased 74% of shares in Uzdunrobita, and 100% in 2007
MTS	2005	Turkmenistan	47	158.4	100	Purchased Barash Communications Technologies, Inc. (BCTI)
MTS	2005	Kyrgyzstan	150	0	51	Purchased controlling stake in Tarino Limited, owner of Bitel
VimpelCom	2005	Ukraine	231	205.2	100	Purchased Ukrainian Radiosystems
VimpelCom	2005	Tajikistan	12	52.2	60	Purchased Takom
VimpelCom	2006	Georgia	13	44.7	51	Purchased Mobitel, member of GMC Group, with the option to purchase the remaining 49%. Contract with Alcatel for the construction of a new GSM/GPRS/EDGE network
VimpelCom	2006	Uzbekistan	260	213.2	100	Purchased Buztel and Unitel, assuming Unitel's liabilities of $7.7 million and Buztel's liabilities of $2.4 million
VimpelCom	2006	Armenia	539.7	88	100	Purchased 90% of shares in ArmenTel from Hellenic Telecommunications Organisation SA (OTE) for $487 million and the remaining 10% from the Armenian government for $52 million, assumed liabilities of €40 million
Altimo	2006	Kyrgyzstan	10	n/i	100	Purchased Sky Mobile from US-Kyrgyz joint venture Katel. Bitel (51% held by MTS) sold to Sky Mobile its fixed assets, rights and liabilities to creditors
KOMSTAR	2006	Ukraine	joint venture	n/i	50	Foundation agreement with Neotel of Ukraine on joint management and development of the subsidiary Komstar Ukraine

Operator	Year	Country	Transaction price ($ million)	CAPEX ($ million)	Stake (%)	Description of transaction
KOMSTAR	2006	Armenia	not disclosed	n/i	75	Purchased Callnet and its 100% subsidiary Kornet
KOMSTAR	2006	Ukraine	4.7	n/i	100	Purchased DG Tel and Technological Systems
MTS	2007	Armenia	425	97.1	80	Purchased K-Telecom (VivaCell trademark) with the option to purchase the remaining 20%
VimpelCom	2008	Kyrgyzstan	350	0	100	Purchased Sky Mobile via Kar-Tel's subsidiary
VimpelCom	2008	Russia	4 240	0	100	Purchased 100% of share in Golden Telecom
MTS	2009	Russia	1 272	n/i	51	Purchased controlling stake in KOMSTAR – United TeleSystems
Sistema	2007	India	58.1	n/i	74	Sistema Shyam Teleservices – joint venture between Sistema and Shyam Group[1] of India
VimpelCom	2008	Vietnam	joint venture	267	40	Joint venture with Vietnamese state-owned company Global Telecommunications Corporation (GTEL)
VimpelCom	2009	Cambodia	28	n/i	90	Purchased 90% of shares in SOTELCO LTD
VimpelCom	2010	Egypt	1800	n/i	51.7	Purchased Weather Investments S.p.A., which offers services in Algeria, Bangladesh, Egypt, Greece, Italy, Pakistan, Tunisia and North Korea.

Table 11.3. Russian operator's presence in oversees markets

Source: Absametova et.al., 2010

Note: [1] At the end of 2010 the Russian Government will acquire 20% in Shyam by partial conversation of the Indian debt;
n/i – no information

In November 2009 Altimo announced a merger of stakes in MegaFon and Turkcell with TeliaSonera with a view to establish a leading international operator which will serve over 90 million subscribers in the CIS and Turkey.

Moreover, Telenor and Altimo signed an agreement on merging their stakes in Vimpel-Communications and Kiyevstar G.S.M. (Bogapov, 2009) and establishing a new mobile operator, VimpelCom Ltd. The new operator provides integrated mobile and fix-line services in Ukraine and other CIS countries, Georgia, Vietnam, Cambodia and Laos.

Today many mobile and fixed-line Internet access providers have entered the triple play market (provisioning of Internet access, television and telephone services over a single connection) (Yefanov, 2008). A brilliant example of conquering new market segments was VimpelCom's purchase of Golden Telecom for a record $4.3 billion in 2008 and purchase of KOMSTAR Unified TeleSystems by MTS in 2009. Therefore, VimpelCom and MTS entered the market of broadband Internet services and evened up scores with fixed-line operators.

The interest of the “big three” in alternative fixed-line operators can be explained by the high demand for Internet services coupled with low competition. The structure of the Internet market is generally identical in all CIS countries (except Russia and Ukraine): a large number of small local providers and one monopolist controlled by the government that owns all trunk networks.

Apart from mobile operators, there are a number of alternative Russian Internet providers on CIS markets. For example, KOMSTAR Unified TeleSystems Group (established in 2004 via the merger of KOMSTAR, MTU-Infor and Telmos) is a leading Internet provider in Russia, Ukraine and Armenia. The group has aggressively invested in telecommunications in other post-Soviet countries. For example, in 2008 it fully financed and launched the world’s first national wireless WiMAX network in Armenia.

The Internet market in the CIS is largely underdeveloped and non-transparent, but the situation is likely to change dramatically in the near future. First, new 3G networks will create a completely different environment; second, the consolidation of CIS markets will inevitably lead to the emergence of transnational operators.

The market analysis shows that the most lucrative segments of the ICT in the CIS, such as mobile communications, have been long dominated by Russian players. On the other hand, de-monopolisation of telecommunications opened CIS markets to large European TNCs which now hold up to 100% of shares in various structures.

Bearing in mind the extinction of the traditional technology principles and enormous profitability of mobile services, any future scenario will be shaped principally by the corporate will of shareholders of leading Russian operators. Events like the recent merger of the assets of Telenor and Altimo suggest that the main players at a regional are established, and no new competitors should be expected to appear on the CIS market in the next few years. Any prospective M&A transactions will depend on the preferences of large shareholders, notably, Telenor and Altimo.

As a conclusion, the market is nearing saturation (in terms of the number of subscribers), and investors are making attempts to breakthrough by introducing highly integrated NGN capable of boosting regional and global traffic, which will result in a better use of the existing capacity.

Corporate integration and formation of Russian “Eurasian transnationals”

Telecommunications provide us with a brilliant success story, as the Russian mobile operators saturated the domestic market and successfully proceeded with expanding their business to other CIS countries.

The fact that the largest players are purely private had a positive impact on their international competitiveness and activity. Liberalisation of telecommunications markets triggered a capital inflow in the sector, which in turn led to improvements in the quality of telecom services. The liberalisation of developed markets and the emergence of cheaper technology fuelled competition and caused companies to seek new sources of income, often outside their home countries.

Heifetz and Libman (2007: 9) define corporate integration as a system of interconnections which emerges within the international intra-corporate space, with products, labor resources and capital in free circulation. Transnational corporations are trade enabling structures which strengthen the benefits of intraregional trade, thus promoting regional integration. Libman (2009) identifies the following tools of corporate integration:

- direct investments and development of production chains within jointly controlled structures;
- international alliances and long-term production cooperation;
- contacts with companies from different countries, which have a common large client.

The first two tools are especially efficient in the CIS telecommunications market. For example, direct investments proved its efficiency in mobile communications (VimpelCom, MTS, Altimo) and international alliances in fixed-line and satellite communications.

According to Danning's classic theory of globalisation, a company can enter international markets using the following strategies:

- export of products or services via distributors;
- export of products or services via its own structures;
- transfer of production assets;
- full-cycle production; or
- international integration of production assets.

The latter three strategies are more useful for strengthening integration. TNCs establish alliances with existing manufacturers of equipment in other countries in the form of joint ventures (e.g. in Russia) or by purchasing companies (the main strategy of Russian mobile operators in CIS countries).

As we have mentioned above, the most common model of integration in post-Soviet countries is corporate investments. It is based on the investment expansion of Russian businesses. In the past decade Russian companies invested about $1.5 billion in mobile communications in the CIS (Libman, 2009).

Territorial proximity and common infrastructure is the basis of a market. In this context, the preserved ties between CIS economies and the ability to use the former shared infrastructure is of key importance. It can be safely said that a number of post-Soviet TNCs emerged due to the ties inherited from the Soviet period. Another precondition for investment integration is social integration: cultural similarities, common traditions and language, similar legal systems, preserved personal contacts, good knowledge of local conditions, and better understanding of the real political and economic situation, as well as similar management styles and organisational culture (Yudanov, 2000) .

Investment flows are asymmetric, with Russian and (to a lesser extent) Kazakh capital playing the main role; the other CIS countries are essentially recipients. On the whole, the CIS has very few centers of formation of new TNCs and a large number of recipient countries.

The scale of private investment cooperation is considerable, but the financial crisis could create serious barriers to corporate expansion. However, it can also weaken national business groups' control over assets, thus promoting the corporate investments model (Libman, 2009).

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12 Russian and Kazakhstani Nuclear Energy: Trends in Economic Cooperation

Aigul Absametova

The purpose of this article is to analyse integration processes in the nuclear energy sector of Russia and Kazakhstan. Particularly, we will focus on the two countries' initiatives in peaceful uses of nuclear energy, and evaluate the progress of the integration projects. We also provide an overview of the world nuclear market, Kazakhstan's and Russia's uranium industries, elaborating on the roles of the Kazakh national nuclear company Kazatomprom and Russian State atomic energy corporation Rosatom, as main representatives of the countries on the international nuclear market. Finally, we analyse some Russian-Kazakh bilateral cooperation initiatives in nuclear sector. The article is based on the EDB sector report no. 11 "Russian and Kazakhstani nuclear energy: trends in economic cooperation".

Introduction

Nuclear energy presently enjoys a renaissance and plays an increasingly prominent role in the world economy. Notably, developing countries that do not possess the necessary technology are the main driving force behind this revival of interest. States that possess immense fossil fuel resources, such as the United Arab Emirates and Saudi Arabia, are also showing significant interest in nuclear energy.

Nuclear energy is three times cheaper than wind energy and five times cheaper than solar energy. The operation of an NPP is more environmentally friendly than other power stations as there are almost no greenhouse gas emissions. In this respect, the full nuclear energy cycle, including uranium mining, nuclear fuel transportation, construction of reactors and disposal of wastes, is comparable to electricity generation from the renewable sources. If all the world's 440 reactors were replaced by thermal power plants, generation of the same quantity of electricity would lead to an annual increase in carbon emission of 3.2 billion tons (Deripaska, 2009).

Swift fluctuations in fossil fuel prices and the rapid depletion of oil, gas and coal deposits prompt the main producers of these resources (including Russia and Kazakhstan) to search for new sources of income. Under such conditions, the uranium industry has the opportunity to become the mainstay of these economies. Moreover, the strong political and economic ties between Russia and Kazakhstan could help them in their quest for leading positions in the global nuclear market. In the near future, cooperation with Russia could enable Kazakhstan to emerge not only as an international supplier of raw materials but also as a nation that has mastered the full nuclear fuel cycle. Russia, in turn, will benefit equally greatly from access to cheap Kazakh uranium.

Trends in nuclear energy development

Both the growing energy dependence of most global economies and volatile fossil fuel prices give rise to the search for new sources of energy. Nuclear energy promises to be one of the most reliable, economic and environmentally friendly solutions. According to the International Atomic Energy Agency (IAEA), the use of nuclear energy plants results in reducing CO_2 emissions by 2.9 billion tons per annum compared to coal-fired generation, or 24% of the total annual energy market emissions (Technology Roadmap, 2010).

The IAEA forecasts a nearly two-fold increase in global demand for energy in the next 25 years, which cannot be met by conventional sources such as oil, gas or coal. In parallel with that, by 2030 global demand for nuclear energy will rise by 66% from the 2008 level (Vestnik Atomproma, 2009b).

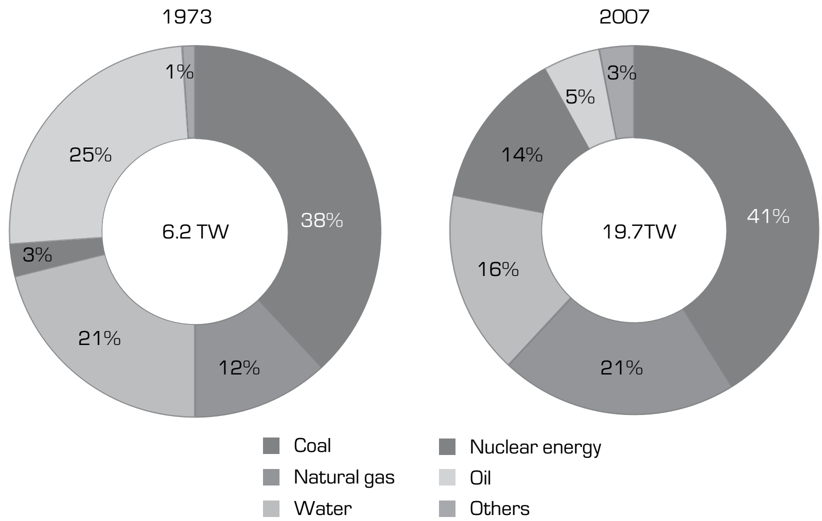

Figure 12.1. Electricity generation by source (1973 and 2007)

Source: International Energy Agency, 2009

According to the World Nuclear Association, in March 2009 there were 436 functional nuclear reactors in 30 countries; 55 reactors were under construction; 108 reactors were at the project preparation stage; and 266 projects were under consideration. Nuclear energy currently provides 16% of the world's electricity. However, nuclear energy policy differs between countries: in France, NPPs generate 78% of all electricity consumed, whereas in China they account for as little as 2%. Yukio Amano, General Director of the IAEA, says that over 50 nations have declared their interest in developing nuclear energy. This interest is driven by the highly volatile prices of fossil fuel and unstable energy supplies. Uranium is much easier to transport, and decreases the cost of electricity 4-6 times, compared to that generated using coal or natural gas (Vestnik Atompromа, 2009a).

Another advantage of nuclear energy is that the fuel component in the tariff for electricity is small, preventing strong fluctuations in electricity rates. For example, a triple increase in the price for natural gas automatically leads to a triple increase in the price of electricity. By contrast, the same triple increase in the price of uranium would result in a 5-6% increase in the price of electricity generated by a NPP (Simakova, 2009), because fuel cost accounts for merely 24% of all nuclear power plant costs (including

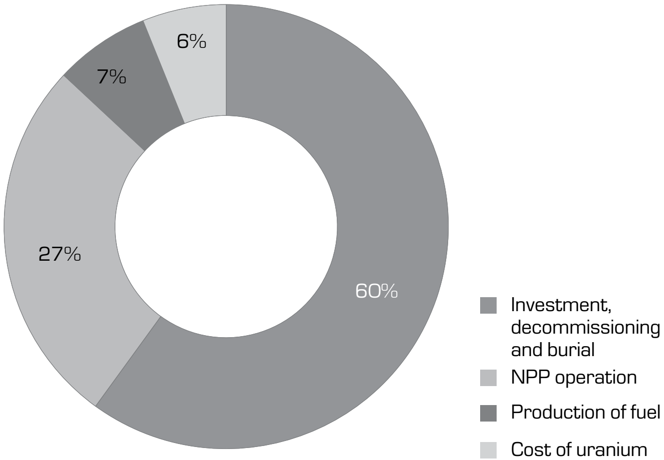

Figure 12.2. Construction and operation costs of NPP

Source: AREVA, 2007

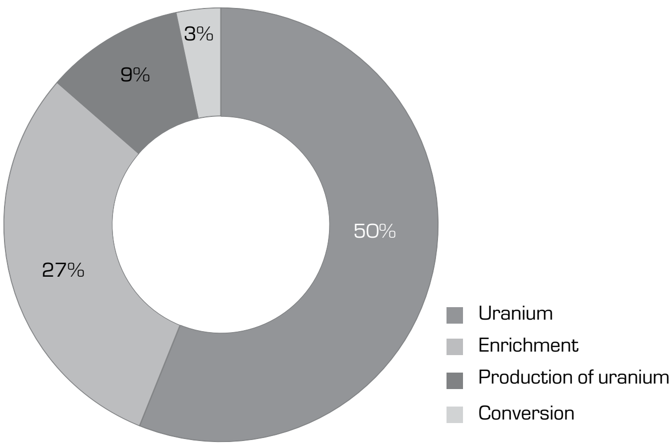

Figure 12.3. Structure of NPP fuel costs

Source: Eurasian Development Bank

Note: based on Bank of Moscow data, 2008 uranium mining, conversion, enrichment and the actual production of nuclear fuel). Most NPPs purchase nuclear fuel under long-term contracts at prices which are typically lower than the market price (this difference can be up to 60%) (Bank of Moscow, 2008). Operation, maintenance and decommissioning account for 58%, and construction for about 18% of all NPP costs (see Figures 12.2. and 12.3).

An important factor in favour of nuclear power plant (especially after the Chernobyl disaster in 1986) is that reactors are subject to strict safety regulations. All new generation reactors are "passively safe" – that is, in case of an emergency the operator does not need to take any special action, as the reactor design features include automatic shutdown (Simakova, 2009).

Analysis of the world nuclear energy market

It should be noted that the nuclear energy market is a combination of several different markets (see Figure 12.4). The first market is natural uranium production and processing. This fully developed market is dominated by 14 countries; ten of them account for 90% of the world's uranium production.

The second is uranium enrichment services market. This market has four key players: Russia, the USA, France and the British-German venture URNCO. Russia controls one quarter of the market (export of low enriched uranium).

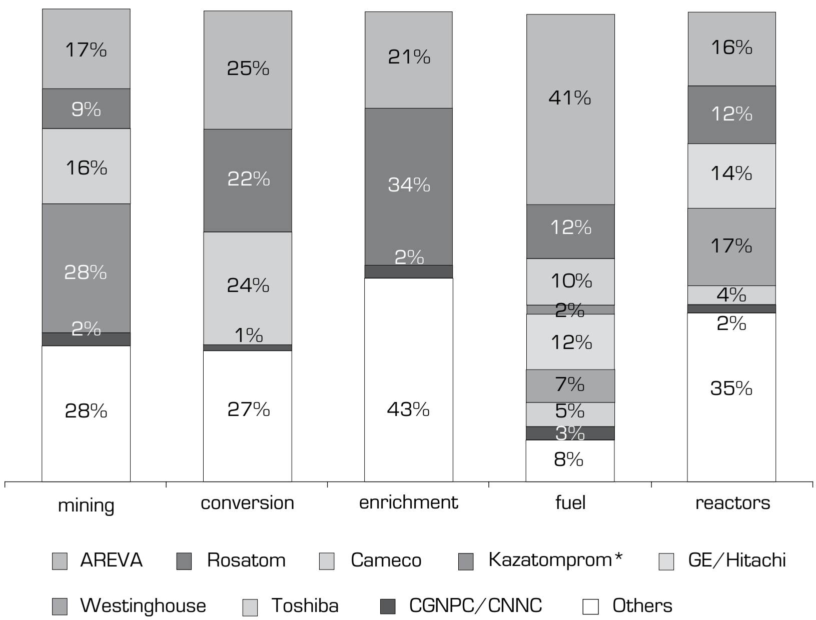

Figure 12.4.
Key uranium market players
Source: Eurasian Development Bank
Note:
* (Kazatomprom, 2010a)

The third market is the production of fuel assemblies. There are many national players on this market. The largest players are TVEL (Russia), AREVA (France), Toshiba/Westinghouse and GE/Hitachi (Japan/USA). This stage of nuclear fuel production accounts for about 6% of the total nuclear fuel cycle cost.

The fourth market is design of reactors. To date, there are several types of nuclear reactors available globally, including Russian, American (General Electric, Westinghouse) and German-French (Siemens-Framatom) designs (Beckman, 2009).

The current status of the Kazakh uranium industry

At present the uranium industry in Kazakhstan shows the most rapid growth rate. The country's current energy resources structure is as follows: coal – 34%, oil – 8.8%, natural gas – 6.6%, minerals – 4.2%, and uranium – 46%. Thus according to Kairat Kadyrzhanov, General Director of the National Nuclear Centre, Kazakhstan is a uranium nation, and it is nuclear energy that can make the country truly competitive internationally (Shaternikova, 2009). This is facilitated by the fact that Kazakhstan has immense uranium deposits, ranking second globally in recoverable reserves (21% of the world's total).

In 2009, uranium production in Kazakhstan rose by 63% to about 14,000 tons. Thus, the country became the leading producer of uranium (28% of the world's production), outperforming Canada (24%) and Australia (19%). To mention, Kazatomprom itself produced only one third of this volume and the rest was mined by joint ventures.

Kazatomprom today

By 2008 Kazatomprom had secured agreements with the key players in the international nuclear market for building conversion, enrichment and fuel assembly facilities, thus finalising its transformation into a vertically integrated company.

Kazatomprom is a holding company comprising 26 subsidiaries engaged in geological exploration; production, processing and enrichment of uranium; production, storing, transportation and processing of molybdenum and copper ores; design of small and medium capacity nuclear reactors; construction of NPPs; generation of electricity and heat; and joint production of nuclear fuel for VVER-1000 type water-cooled power reactors. Kazatomprom owns a uranium plant, a tantalum plant and a beryllium plant which supply materials to the nuclear, aerospace, electric and instrument-making industries, and has commenced construction of sulphuric acid and enrichment facilities at the Ulba Metallurgical Plant.

Kazatomprom also has a research centre, a special training centre and an educational centre. On the whole, Kazatomprom and its affiliate Stepnogorsk Mining-Chemical Complex LLP employ about 22,000 people. Kazatomprom and its subsidiaries operate 16 deposits in Kazakhstan.

Kazakhstan's uranium production in the first half of 2010 totaled at 8,452 tons – a 42% surplus compared to the same period of the previous year. According to reviewed production plans, 9,770 more tons will be mined in the second half of 2010. The growth was achieved by increased production in almost all subsidiaries of the holding; particular mention should be made on the commencement of commercial production by Baiken-U LLP and Kyzylkum LLP and pilot production by the Akbastau joint venture (Invest-market, 2010). Kazatomprom's gross income in the first half of 2010 amounted to 105.687 billion tenge – a 58% rise compared to the first half of 2009. Net income was 19.414 billion tenge (a 64% rise) (Kazatomprom, 2010).

One of the major events of 2010 is the placement of Kazatomprom's debut 5-year Eurobonds for $500 million with a 6.25%-coupon. The order book totalled $4.3 billion. The proceeds will be used to expand production and repay loans ($50 million will go towards the subsidiaries' most expensive borrowings). Kazatomprom is also considering acquiring companies that possess uranium conversion and enrichment technology (Kazatomprom, 2010).

Kazatomprom's nuclear fuel cycle

Prior to independence, Kazakhstan's uranium industry was under the control of the Soviet military nuclear agency code-named the "Ministry of Medium Engineering". After the disintegration of the Soviet Union the country mastered two steps of nuclear fuel cycle – uranium mining and production of uranium dioxide pellets. The company plans to set a vertically integrated complex capable of running a full nuclear fuel cycle. The State Programme for Industrial Development in 2010-2014, in particular, provides for the development of missing nuclear fuel cycle stages (conversion, enrichment and production of fuel assemblies) (see Figure 12.5).

Nuclear fuel cycle stages already mastered by Kazatomprom are marked green; stages to be obtained under the company's development strategy are marked blue; and stages which will not be developed are marked red.

Kazatomprom is currently engaged only in uranium mining and fabrication of UO_2 powder and pellets. Notably, 6,537 tons out of 6,609 tons of the company's uranium sales in 2009 were sold in the form of raw material – triuranium octoxide (U_3O_8). U_3O_8 accounts for just 35% of the cost of fuel assembly (Business Resource, 2010).

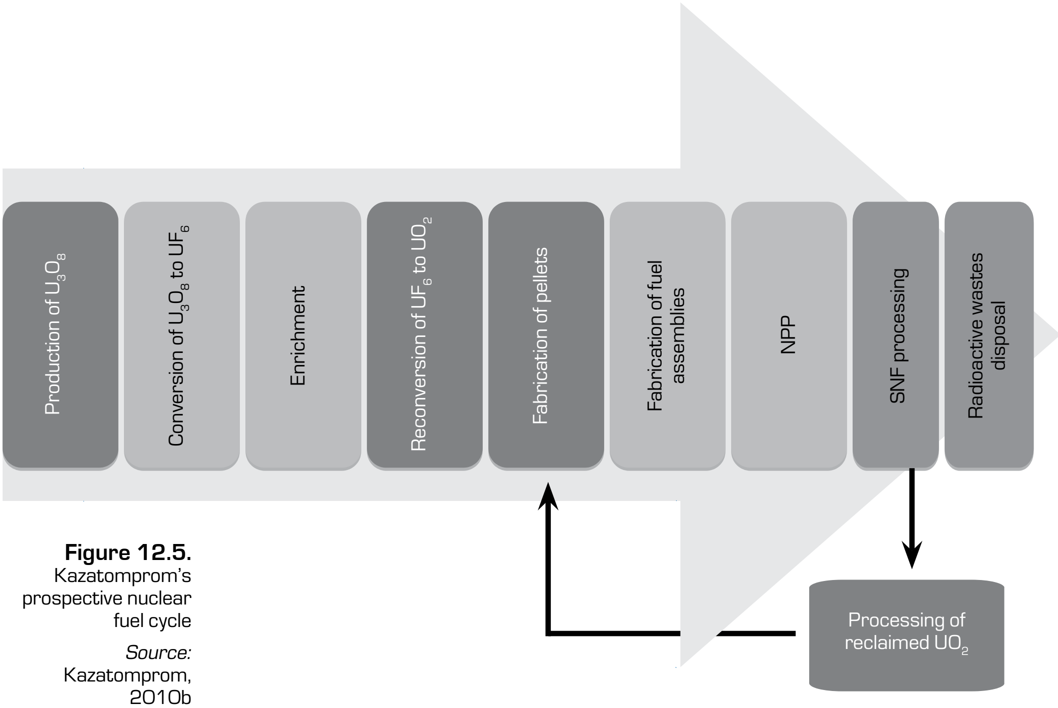

Figure 12.5. Kazatomprom's prospective nuclear fuel cycle

Source: Kazatomprom, 2010b

Table 12.1. Fuel assembly cost structure ($1 million)

Source: Business Resource, 2010

Note: highlighted columns indicate nuclear fuel cycle stages mastered by Kazatomprom

Raw material (U_3O_8)	Conversion to hexafluoride (UF_6)	Enrichment	Fabrication of UO_2 powder and pellets	Alloys	Fabrication of fuel rods and assemblies
35%	4%	37%	6%	9%	10%

The current status of the Russian uranium industry

The Russian government attaches great importance to nuclear energy development. About 1 trillion roubles will be invested in this industry by 2015, and another 68 billion roubles will be allocated from the federal budget for the construction of new NPPs (Beroyeva, 2010). Special positions will be created in selected Russian embassies whose responsibility will be to lobby and promote Russian nuclear technology (Kommersant FM, 2010).

Rosatom is a corporation comprising over 240 companies and organisations. These include all civil nuclear companies, military nuclear companies, research institutions, organisations in charge of nuclear and radiation safety, and the nuclear icebreaker fleet. Russian nuclear industry employs over 190,000 people. Uranium is mined by three companies: Priargunsky Mining and Chemical Works JSC, Dalur CJSC and Khiagda JSC.

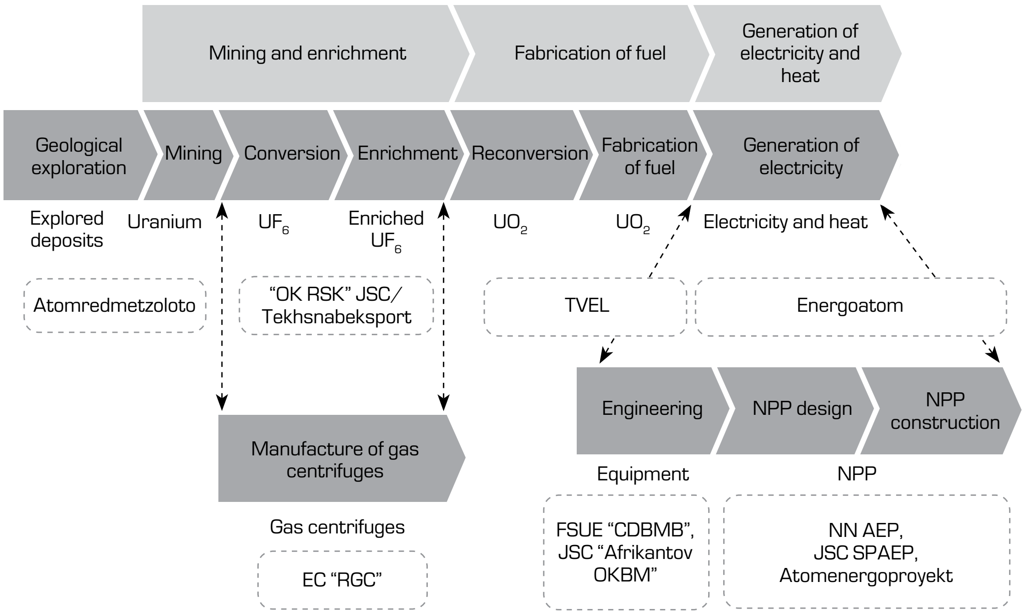

Figure 12.6.
The current status of the Russian uranium industry
Source: Rosatom, 2010

In 2006 it was decided to establish a specialised vertically integrated company for producing NPP equipment. Nuclear industry was divided into the military and civil segments. All companies in the civil segment were reorganised into joint stock companies, with the corresponding transformations in terms of accounting. According to Rosatom's General Director Sergey Kiriyenko, the reform was successful: the value of the corporation's net assets rose by 360% and productivity by 170%. In 2009 Rosatom's income totalled 518 billion roubles, a 37% surplus compared to 2008 (Kommersant FM, 2010).

Geological exploration was carried out in fields operated by existing and prospective Russian ventures. Some 170,000 running metres were drilled, and total investments in uranium exploration amounted to 1.05 billion roubles. It is expected that a reserve increment of uranium will amount to 8,000 tons. In addition, geological exploration was started in Armenia and Namibia (Vestnik Atompromа, 2010v).

Even now Rosatom has an advantage on the international nuclear energy market, as it has mastered the full nuclear fuel chain from uranium mining to the construction of NPPs (only French AREVA can compete with Rosatom in this regard). Rosatom controls 34% of the enrichment market, 22% of the conversion market, 12% of the nuclear fuel market and 12% of the

NPP construction market. However, the corporation is not satisfied with its current status. During the visit to Volgodonsk NPP Russian Premier Minister Vladimir Putin said: “We need to strengthen our positions in the field of peaceful nuclear energy. These are unique technologies. It is within our power to capture at least 25% of the NPP construction and operation services market. We should actively offer not only NPP construction services, but also operation and maintenance and fuel disposal services” (Beroyeva, 2010).

Russian–Kazakh cooperation

Apart from Rosatom, the most active player in the CIS is Kazatomprom. Hence, successful cooperation between these two giants is a precondition for progress not only in the national nuclear energy sectors, but also in the Kazakh and Russian economies in general. Therefore, on December 7, 2006, a comprehensive programme of Russian-Kazakh cooperation in peaceful uses of nuclear energy was adopted, and on November 20, 2009 the parties signed a Roadmap of additional measures for implementing that programme.

On many occasions, the presidents of Rosatom and Kazatomprom have voiced the idea of recreating a single structure identical to the former Ministry of Medium Engineering in a new format. The fact that Russia and Kazakhstan are discussing the creation of a unified nuclear agency has been known widely for long. Respective plans were announced by the Presidents of the two states in a series of negotiations (Gilyova, 2010). The establishment of a unified structure would be beneficial to both parties: Kazakhstan would be able to create high-technology production facilities through which would address a wide range of issues (increase tax revenues, decrease unemployment rate, solve the power shortages problems, etc.), and Russia would gain access to cheaper uranium.

However, these negotiations are still dragging on. In Rosatom’s opinion, the Kazakh party is deliberately protracting the process. Initially Rosatom insisted on owning 50% plus one share, and Kazatomprom stood for parity terms. In the autumn of 2008 Russia agreed to the parity terms which included, inter alia, exchange of all Kazakh assets for equal Russian assets (at market value). Rosatom delivered a draft of intergovernmental agreement establishing a unified company, but no reply followed.

On June 9, 2010, at the ATOMEXPO exhibition, Kazatomprom’s Vice-President Nurlan Ryspanov announced a forthcoming uranium development programme under which Kazatomprom is scheduled to complete its transformation into vertically integrated company with a full nuclear fuel cycle by 2020 (ATOMEXPO, 2010a). In particular, the uranium conversion was entrusted to the specially founded joint venture Ulba Conversion LLP (with Cameco, Canada).

There is also a contradiction between Russia and Kazakhstan concerning the construction of an NPP in Kazakhstan. According to Kazatomprom, at present a respective feasibility study is being agreed. According to the Russian party, a draft agreement was approved and passed to the Kazakh Ministry of Energy and Mineral Resources in 2009. In February 2010 Russia received a new Kazakh version of the agreement. According to Russian party, this version virtually brings the discussion back to the starting point (Konstantinov, 2010).

There were also some positive developments. On July 5, 2010, during the working visit of Russian President Dmitriy Medvedev to Kazakhstan, an added impetus was given to the integration of the two states' nuclear energy sectors. Rosatom's General Director Sergey Kiriyenko and Kazatomprom's President Vladimir Shkolnik signed two documents: a Memorandum on integration and cooperation in the field of peaceful uses of nuclear energy and a Joint Statement on the uranium enrichment centre project.

The first document outlines a concept for gradual establishment of a Russian-Kazakh nuclear company. "The parties confirm that they shall adhere to the principles of integration and, whilst taking consecutive steps towards a unified, parity-based nuclear company, shall strive to position it on the global nuclear fuel cycle market as a strong joint player, and make use of market conditions in the best interests of future integration", reads the memorandum (Baranov, 2010). At an initial stage, this company will sell natural and low enriched uranium, as well as other products and services produced by the joint ventures to end users. The second document seals the parties' agreements in respect of common use of a uranium enrichment centre in Russia through Kazakhstani shareholding in the Ural Electrochemical Integrated Plant JSC. Moreover, the document outlines the principles of concerted sales and marketing policy.

Thus Kazakhstan receives access to the world's largest enrichment facility and can increase the value added of nearly a half of all uranium it is now selling to the markets as a raw material. This will reduce Kazatomprom's dependence on the volatile prices of natural uranium (enrichment services are more stable and predictable). Moreover, the enriched uranium is much more expensive than the natural one. The two documents are equally beneficial to Russia as well.

First, they provide for processing of Kazakh uranium on Russian territory, i.e. Rosatom has secured additional workload for its facilities. Second, Russia has secured the Kazakh government's support for the forthcoming purchase of assets of Canadian Uranium One by Atomredmetzoloto (see below).

In 2006 ARMZ and Kazatomprom started the consolidation of assets by creating two joint ventures, Zarechnoye and Akbastau. In addition to the creation of joint ventures, Russian companies enter the Kazakh market by acquiring international uranium companies which operate deposits in Kazakhstan. For example, ARMZ has acquired Effektivnaya Energiya N.V. which owned 50% in Karatau LLP and 25% in the joint venture Akbastau. As a result, ARMZ consolidated Russian assets in Kazakhstan and doubled its production capacity (Vestnik Atompromа, 2010b).

In 2009 ARMZ purchased 16.6% of shares in Uranium One. To be specific, ARMZ exchanged its 50% share in Karatau LLP for 117 million ordinary shares in Uranium One Inc. plus $90 million; up to $60 million more will be paid if Karatau achieves certain financial results within three years. Therefore, ARMZ gained the right to purchase part of Uranium One products (Interfax, 2010).

In June 2010 Atomredmetzoloto entered into another agreement with Uranium One under which it will increase its share in Uranium One by purchasing an additional share issue (356 million ordinary shares) for 50% in Akbastau and 49.7% in Zarechnoye plus $610 million. After closure of this transaction ARMZ's share in Uranium One will account for at least 51% (and, as a result, ARMZ will have the right to acquire at least 51% of Uranium One's products) (Tserikh, 2010).

Transaction is subject to the approval of all regulatory authorities in Russia, Kazakhstan, the USA and Australia. According to recent reports, the US Committee on Foreign Investment has approved the transaction on October 25, 2010. Thus, Atomredmetzoloto's assets in Kazakhstan will comprise Akbastau, Zarechnoye, Betpak Dala, Karatau and Kyzylkum uranium fields with total reserves of 133,293 tons.

Rosatom is in the lead in terms of the number of joint projects with Kazatomprom and total uranium production (over 25% of Atomredmetzoloto's uranium output in 2009 was mined by joint ventures in Kazakhstan, and this figure is expected to increase in 2010). ARMZ plans to strengthen cooperation with Kazakhstan not only through its own subsidiaries but also by supporting the Kazakh subsidiaries of Uranium One. For example, it is expected that Karatau will boost the output of processing solutions to meet the needs of the Akbastau deposit) and, in the longer term, develop refining production based on Karatau JV and build a sulfuric acid plant.

Despite the disagreements, Kazakhstan and Russia recognise the need for collaboration in the nuclear industry, as illustrated by the recent bilateral initiatives. We can presume that the former management of Kazatomprom aimed to maintain a balance between the interests of Russian and other foreign investors and not to allow any particular group of investors to dominate. The current management takes a pro-Russian stance. This, in our opinion, would greatly facilitate the process of integration of two countries.

Conclusions

The main objective of this industry review was to describe the current status of the global nuclear energy market and nuclear energy market in Russia and Kazakhstan. Our analysis of integration processes in the peaceful uses of nuclear energy in the CIS shows that both Kazakhstan and Russia attach great importance to the development of nuclear industry. Possession of nuclear technology enables a nation to diversify the entire economy – this is especially relevant to large exporters of raw materials and fossil fuel such as Russia and Kazakhstan, as they are highly dependent on world prices for energy resources.

The international nuclear energy market is dominated by competing giants such as AREVA, Cameco and others. In order to keep footing on the market, a country must possess both a strong uranium base and the entire technology. Neither Kazatomprom, which controls immense reserves yet has mastered only two nuclear fuel cycle stages, nor Rosatom, which has mastered the entire nuclear fuel cycle yet has access only to expensive uranium, can boast of having access to both components. Therefore, cooperation between these two companies is the most favorable decision. The understanding of this fact has long been there, but progress is being delayed by various contingencies, resulting in unnecessary losses.

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13 Chronicle of Eurasian Regional Integration 2010

Natalia Maqsimchook

2010 is notable first of all for the commencement of the Customs Union of Belarus, Kazakhstan and Russia. In early 2010, business circles faced difficulties with the introduction of import licensing for an array of goods, including some types of alcohol, electronics and medications, and had to halt imports of these products. The CU member states still pose questions concerning the customs and tariff regulations; however they showed understanding of inevitable need for fine-tuning of a new mechanism during the first stage, performed by the Customs Union Commission.

The launch of the Customs Union of Belarus, Kazakhstan and Russia remained in a focus of public attention during the first half of 2010. It was expected that the CU would come into force on July 1, 2010, with the adoption of the Customs Code by the three member states. However the parties' disagreement over a number of sensitive issues led to the approval of the Customs Code by two out of the three member states. On July 1, 2010 the Customs Code of the Customs Union came into force in Kazakhstan and Russia, and the first customs-free rail shipment of 700 tons of wheat was successfully transported from Kazakhstan to Makfa, a Russian manufacturing enterprise situated in Chelyabinsk. Despite the difference in the CU member states' positions over the abolition of export duties, on July 6, the Customs Code came into force in all three states. Unresolved issues between Russia and Belarus on Russia collecting export duties for supplies of oil products to Belarus led to a gas conflict, which was settled only after both sides demonstrated readiness to go to extreme measures.

The main highlight of the Regional Organisations section is the continuing work on the use of national currencies in settlements between the CIS member states, which is interrelated with issues of the reorganisation of the CIS Interstate Bank. Having taken over the chairmanship of the CIS in 2010, Russia is advancing the initiative on the establishment of the CIS Free Trade Zone. A corresponding agreement will be presented to the CIS heads of governments for signing in the first half of 2011. The agreement is designed to replace over a hundred current agreements and arrangements.

One of the central news from EurAsEC is the signing of a Declaration on establishing a single economic space for Belarus, Kazakhstan and Russia. The parties undertook great efforts to prepare and harmonise the international agreements that laid the foundation for the successful operation of the Common Economic Space of the three countries. It will take several years to unify economic laws and regulations. Basic provisions will come into force starting January 1, 2012. Some issues will demand a longer transition period that will last up to 2017-2020.

With the establishment of the Customs Union and the Common Economic Space, Russia, Belarus and Kazakhstan advance towards creating a Eurasian Economic Union that will ensure a mutually beneficial cooperation with other countries and international economic alliances.

The SCO membership is likely to increase, as the heads of SCO member states signed an array of documents, including the Regulations on procedure for admitting new members to the Shanghai Cooperation Organisation.

CSTO revises its emergency response mechanism after a failure to respond adequately to the interethnic collisions in Kyrgyzstan in June.

Russia-Ukraine relations are to be noted in the block of bilateral relations, as traditionally challenging set of issues. However, the change of country's political leadership gave start to new positive trends. Throughout 2010, the presidents, prime ministers and key ministers of both countries held several meetings. Among the most important developments are the signing of a set of "Fleet-for-Gas" agreements, discussion of prospects for a possible joint Gasprom and Naftogaz venture, as well as several joint projects in nuclear energy, transport infrastructure and aircraft engineering.

Russia and Azerbaijan are moving towards signing an agreement on the legal status of the Caspian Sea. During a state visit of the Russian president to Armenia the sides signed agreements on cooperation in the military and political spheres, including the prolongation of deployment of Russian military base in Gyumri and widening its geographic strategic responsibility, as well as joint projects for the construction of new power units at the Armenian nuclear power plant. The period of deployment of military bases in Kyrgyzstan is also being prolonged. The heads of Russia and Tajikistan met during the CIS August summit in Sochi and settled outstanding problematic issues on the repayment of Tajik energy debt, the construction of Sangtuda hydropower plant (HPP), the deployment of Russian Air Force at a base in Gissar, and the supplies of Russian oil products at a discount price.

Kazakhstan is in search of new oil transportation routes and nuclear energy development partners. The agreement on parallel operation of Russia's Unified Energy System (UES) and power grids of Belarus and Ukraine is bringing positive results. Russian Railways and Kazakhstan Temir Zholy are joining forces in the competition with sea transportation by introducing a simplified freight customs clearance procedure and establishing a unified customs broker.

Russian companies report facing risks in their operations in the CIS member states. One of Russia's largest dairy manufacturers lost its local assets in Uzbekistan after its local branch was de facto nationalised "in profit of state". Barash Communications Technologies, Inc., a subsidiary of Russia's MTS, halted its operations in Turkmenistan. Russian Transmashholding managed to successfully complete the acquisition of Ukrainian Luganskteplovoz, and Polyus Gold resolved the controversy over the reverse takeover deal with KazakhGold.

Late 2010 was also marked with considerable activity in the financial sector. Belarus successfully placed its 2-year sovereign rouble denominated bonds on MICEX; thus becoming a first foreign issuer to place bonds in Russia. Sberbank established a direct investments fund for Belarus. Kazakh-Tajik fund for direct investments was also put into operation. The Council of the heads of state agencies for regulation of securities markets of the CIS member states reviewed issues on interaction between the CIS stock markets, and with the introduction of the "Agreement on agreed principles of monetary policies in the member states of the Common Economic Space", Russia, Kazakhstan and Belarus moved further towards establishing unified conditions for the banks and currency markets of the three countries.

REGIONAL ORGANISATIONS

CIS

CIS studies possibility of shifting to regional currencies

March 10, 2010

On March 10–11, the CIS Expert Group discussed a possible way for the Post-Soviet countries to shift to settlement in national currencies in mutual trade. However, the structure of the turnover within CIS appears to be a main obstacle. Russia sells a lot more goods to neighbours than buys from them and a shift away from the US dollar would create an imbalance. The inflow of national currencies to Russia would substantially exceed the demand for these currencies, thus building up excessive liquidity. The scheme for calculating the national currencies' exchange rate also remains an unresolved issue. The Central Bank of Russia only sets the nominal exchange rates for national currencies, while the real exchange rates are determined at the stock exchange. There is no trade in the CIS national currencies at present.

The issue of shifting to national currencies, including the rouble, is of principal importance to Russia, which intends to become a regional financial centre. However, according to experts, the transfer to the new settlement scheme should not be expected in the near future due to complexity of technical regulations.

RBK Daily

Russia suggests turning CIS into free trade zone

March 31, 2010

The government of Russia developed a project to establish a free trade zone within the CIS and expects that it will be approved by the Commonwealth this year. The initiative should boost the modernisation of Russian economy by means of innovative cooperation and technology transfer with neighbouring countries. Russia takes chairmanship in the CIS in 2010 and the multilateral free trade zone project will top the agenda of Russia's chairmanship. Various free trade agreements have been in force in the CIS since the early 1990s but all of them are of a bilateral character. The level of trade liberalisation in the CIS multilateral free trade zone would be lesser, compared to the Customs Union. However, the Customs Union is designed to offer a single trade policy with regard to non-member countries, which is not the case with the CIS multilateral free trade zone agreement. Certain branches related to trade, however, would still require harmonisation. According to Russia's Deputy Prime Minister Igor Shuvalov, Russia intends to almost fully harmonise the economic regulations with all the CIS member states that are not party to the Customs Union or the EurAsEC.

RBK daily

Reorganising CIS Interstate Bank

May 12, 2010

The CIS Executive Committee held a regular meeting of the Commission on Economic Issues under the CIS Economic Council. The participants of the meeting discussed the activities of the CIS Transport Coordination Council in 2006-2009, the draft forecast for energy production and consumption by CIS member states for the period to 2020, as well as the issue of introducing amendments to the conditions of production and technology operations, according to which the country that performed the production and technology operations is considered the country of origin of the goods. The Commission also reviewed the progress on the implementation of the CIS supreme authorities' instructions on the reorganisation of the Interstate Bank. The issue of developing recommendations for defining the goals and functions of the Interstate Bank was included in the action plan for implementing the first stage of the CIS Economic Development Strategy in 2009-2011. The Bank's major functions include arrangement and settling of accounts between economic entities and other CIS organisations in national and other currencies; loan financing of foreign trade operations of economic entities and other CIS organisations among others.

Analysis Unit of the CIS Executive Committee's
Strategy and Research Department

Prospects of interaction between CIS stock markets

October 21, 2010

Kazakhstan hosted the 11th meeting of the Council of heads of state agencies for regulation of securities markets of the CIS member states on October 20-21, which was attended by representatives of Armenia, Belarus, Kazakhstan, Moldova, Kyrgyzstan, Russia, Tajikistan and Ukraine.

The participants exchanged information on the current state of stock markets in the CIS member states in the post-crisis period. The issues of establishing an International Financial Centre in Moscow and interacting with the Council for regulation of securities markets, as well the issue of establishing a coordinating agency within the framework of the Council in order to boost the creation of the International Financial Centre topped the agenda of the discussion. Following the results of the discussion, the parties agreed to review these issues again.

The participants reviewed Russia's draft recommendations for regulating the activities of the CIS investment funds, discussed the results of the CIS national legislations' comparative analysis, as well as issues of taxation at the securities markets raised on the initiative of Belarus and Kyrgyzstan. Moreover, the sides discussed the draft action plan of the Council for 2011-2012, and approved a research and information report on the state of the securities markets in the CIS member states, prepared by the Central Bank of Armenia.

www.cis.by

CIS discusses draft agreement on free trade zone

December 23, 2010

Maxim Medvedkov, director of the trade negotiations department of the Russian Economic Development Ministry and head of the working group on negotiating a draft agreement on a free trade zone, chaired the regular meeting of the working group in Moscow. Representatives from Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Uzbekistan and Ukraine took part in the meeting. The working group asked Armenia, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan to file their positions on the list of international documents that will cease to be effective with the adoption of a new agreement to the CIS Executive Committee by January 15,

2010. The CIS member states should also clarify their positions on certain articles and clauses of the agreement, settle the issue of specifying the list of import duties exemptions, and provide information on domestic progress in putting into force the Agreement on the Rules for Determining the Country of Origin of Goods in the CIS, dated November 20, 2009. The next meeting for the purpose of the final approval of the draft agreement will be held on February 8-10, 2011.

Analysis Unit of the CIS Executive Committee's Strategy and Research Department

EurAsEC

EurAsEC Anti–Crisis Fund receives first applications

February 25, 2010.

The Board of the EurAsEC Anti-Crisis Fund (ACF) approved a set of documents, including the rules for allocation of investment financing from the Fund's resources. The rules set the lower limit for investment loans to low-income countries at $10 million and $30 million to other countries. Moreover, the Council approved the limits for each of the member state. The access limit is an amount of the Fund's resources that can be allocated to a member state either in the form of stabilisation loan or investment financing. The access limit is proportional to the gross national income per capita. According to the data for 2010, limit for Armenia is set at 13% of the Fund's finances, Belarus – 21%, Kazakhstan - 24%, Kyrgyzstan - 3%, Russia – 37% and Tajikistan – 2%. At present, the Fund's total capitalisation amounts to $8.55 billion.

INTERFAX-AFI

Note: The EurAsEC Anti-Crisis Fund was established by the Heads of Governments of Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan. It aims to help the countries cope with the negative effects of the global financial crisis on the national economies, as well as secure their economic and financial sustainability and facilitate the integration processes between the EurAsEC member states. The Fund provide loans to the countries for anti-crisis goals, stabilisation loans and financing for the implementation of Interstate investment projects. The Fund's resources will be distributed on conditions of maturity, serviceability and recoverability. During the voting process each country's votes will carry weight in proportion to their contributions to the Fund. The fund will have $8.5 billion in charter capital. Russia will supply $7.5 billion, Kazakhstan $1 billion, Belarus – $10 million, and Kyrgyzstan, Tajikistan and Armenia – $1 million each. The fund will be managed by a council made up of the finance ministers of the participating states and representatives of participating international organisations. The chairman will be elected by the council members, whose votes will carry weight in proportion to their contributions to the fund. Each vote is the equivalent of $100,000 in contributions. The Eurasian Development Bank facilitates as manager of the Fund's resources.

Tajikistan to be the first to receive funds from EurAsEC Anti–Crisis Fund

June 18, 2010

The Board of the EurAsEC Anti-Crisis Fund has approved the first application for allocation of funds. During the meeting of the ACF Board in St. Petersburg the finance ministers of the ACF member states – Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Armenia – made the decision to allocate a $70 million loan to Tajikistan with a maturity of 20 years (including five year grace period), and a fixed interest rate of 1% per annum.

The Government of Tajikistan intends to use the loan to maintain budgetary financing for social sectors (education, health, and social protection). Moreover, the ACF loan will allow Tajikistan to maintain budget expenditures for healthcare, education and social protection at a pre-crisis level and support reforms in public administration and public finance management.

www.eabr.org

Belarus pays its share in EDB

June 22, 2010

Belarus paid in its share of $15 million in the charter capital of the Eurasian Development Bank (EDB), thus completing the procedures required for joining the EDB, and became the fifth full member along with Russia, Kazakhstan, Armenia and Tajikistan. At present, the Bank is reviewing a number of investment projects in Belarus, including a project to construct the Polotskaya Hydropower plant on the West Dvina.

Reuters

Heads of governments of Customs Union member states reach agreement on oil and gas issues

October 15, 2010

Russia reached a compromise on the contentious issues in the oil and gas relations with the countries of the Customs Union, Russian Prime Minister Vladimir Putin said after a session of the Council of Ministers of Russia and Belarus and the meeting of the heads of governments of the Customs Union member states.

According to Putin, after Belarus signs and ratifies the set of agreements on the Common Economic Space, Russia will abolish import duties on crude oil deliveries to Belarus.

Russia is ready to discuss the participation of all CIS and EurAsEC partners in such integration unions as the Customs Union and the Common Economic Space. Tajikistan and Kyrgyzstan expressed their readiness to join the Customs Union and the Common Economic Space. However, according to Russian Prime Minister, the admission process for the new members wouldn't be straight forward, as countries that join later will have to accept the conditions set by Russia, Belarus and Kazakhstan.

INTERFAX

Establishment of a unified antimonopoly agency of the Customs Union

October 19, 2010

From 2011, the functions of the antimonopoly agencies of the Customs Union member states will be transferred to the Customs Union Commission. According to the Chairman of Kazakhstan's Agency for Competition Protection, Mazhit Esenbayev, a supranational antimonopoly body will start handling unfair competition, monopolies and cartel conspiracies. According to the head of the Economic Development Ministry's department for developing competition, Aleksandr Pirozhenko, the respective agreements have been reached but the principle of creating a unified antimonopoly agency is still under discussion.

For now, the antimonopoly bodies of the Customs Union member states plan to conduct a joint investigation into the overpricing of roaming services by mobile operators. However, a supranational body may handle more complicated cases. According to the Ministry of Economic Development, before the formation of the Customs Union, Belarus was in the lead in applying restrictive measures, with 23 restrictions against Russian products, 17 cases of restricting goods from the EU and 10 restrictions against Ukrainian products. At the same time, Russian dairy manufacturers and producers of agricultural equipment filed complaints against unfair competition on the part of Belarusian companies.

The Customs Union Commission will receive its new antimonopoly functions on a gradual basis. The Customs Union Commission will also start handling unfair competition on a transnational level 20 months after the signing of an agreement, cartel conspiracies after 22 months and abuse of the dominant position after 24 months. The countries now need to formulate a regulatory framework for the Customs Union Commission activities and the rebuttal procedure, as well as harmonise their own legislative acts on competition.

Vedomosti

Russia, Belarus and Kazakhstan sign agreements on Common Economic Space

December 9, 2010

The participants of the EurAsEC Interstate Council's meeting at the level of heads of states discussed issues surrounding basic development trends of EurAsEC, the Customs Union and the EurAsEC Common Economic Space. The sides also signed 17 documents that regulate the establishment of the CES, including agreements on trade in services and investments in the CES member states, a coherent macroeconomic policy, the creation of conditions in the financial markets for the free movement of capital, and the agreed principles of monetary policies.

The presidents of Belarus, Kazakhstan and Russia signed a declaration on establishing the Common Economic Space, according to which the CES will start operating on January 1, 2012. By developing the Customs Union and the Common Economic Space, EurAsEC is moving towards the creation of a Eurasian economic union that will secure a well-balanced, complementary and mutually beneficial cooperation with other countries, international economic alliances and the European Union.

However, according to Russian Economic Development Minister Elvira Nabiullina, it will take several years to unify economic laws and regulations. Basic provisions will come into force starting January 1, 2012. Some issues will demand a longer transition period that will last up to 2017-2020.

http://www.tsouz.ru, RBK daily, Expert Online

Customs Union

Customs Union Commission adopts resolution on deposition and distribution mechanism of import customs duties

March 25, 2010

The Customs Union Commission held a working meeting in Moscow. During the meeting the members of the commission adopted a resolution on Establishment and Application of the Procedure of Deposition and Distribution of Import Customs Duties (other duties, taxes and fees of similar effect).

According to a resolution, the import customs duties equal 4.7% for Belarus, 7.33% for Kazakhstan and 87.97% for Russia.

www.tsouz.ru

Ukraine may join Customs Union

February 19, 2010

Russian president Dmitry Medvedev held a meeting with the head of the Federal Customs Service Andrey Belyaminov. During the meeting, Medvedev instructed the customs chief to study the issue of admitting Ukraine to the Customs Union of Russia, Belarus and Kazakhstan. The Russian president expressed willingness to have closer cooperation with Ukrainian colleagues as the turnover between the countries is quite considerable.

Official representatives of Ukraine are cautious about joining the Customs Union. Ukraine views the Customs Union as an important integration process and intends to take part in certain stages in accordance with the country's national interests. Taking into account the country's membership in the WTO, Ukraine will not become a full member of the Customs Union. Ukraine is more interested in cooperating with Belarus, Russia and Kazakhstan within the framework of the single customs territory.

Ъ-Online

Customs Union Commission broadens mandate

March 18, 2010

From 2012 onwards, Russia, Belarus and Kazakhstan may delegate a substantial part of the national governments' powers to the Customs Union Commission, following the scheme that was used for the establishment of the Customs Union.

According to Kazakhstan's Prime Minister Karim Masimov, the Customs Union Commission needs to be strengthened and broadened via the transfer of some functions of state administration, including, in particular, regulation of natural monopolies, tariff design in this area, unified competition policy, and energy policy. This is a wide process that needs to be strengthened by coherent and ratified agreements between the three countries.

The field of the Customs Union activities includes a common customs territory and external borders, as well as unified trade policy. The Common Economic Space is the next step towards a unified competition policy, unified tariff policy with regard to natural monopolies and an array of other policies being deliberately transferred to the supranational bodies' sphere of duties by the heads of sovereign states. However, according to Masimov, tax policy should remain a duty of the sovereign government. It is likewise early to speak of a single monetary union since central banks should remain non-integrated. Nuclear energy is also an exception because it can't be transferred to the duties of the Common Economic Space.

Note: The Customs Union of Russia, Belarus and Kazakhstan was launched on January 1, 2010. Starting July 1, 2010 The Customs Code of the Customs Union comes into force and the Single Economic Space of the three states will be established by January 1, 2012.

Kazakhstan had a hard time making a decision on raising the protective import tariffs for cars and aircraft engineering to Russia's level.

Kursiv

Approval of regulations for fuel and motor transport in the Customs Union

May 6, 2010

Russia's Industry and Trade Ministry redrafted technical regulations for motor fuel, motor transport and motor vehicle emissions. The documents now need to be approved by Belarus and Kazakhstan and will come into force in 2011.

The key adjustment made to the new technical regulations for gasoline and aviation fuel, diesel and marine fuels, jet engine fuel and burner fuel is the toughening of requirements for fuel grade. According to specialists, synchronisation of environmental requirements for fuel and motor transport in the Customs Union may lead to serious problems. While Russian and Belarusian oil refineries are ready to shift to Euro-3 grade fuel, Kazakhstan's refineries will need time and investment to upgrade from Euro-2. In order to avoid tough restrictions, Russia's partners suggest dividing the fuel technical regulations into three parts, foreseeing different environmental requirements for gasoline, marine fuels and aviation fuel apart from lowered environmental requirements for diesel fuel for agriculture needs. Russia advocates a simultaneous synchronisation of requirements for fuels, vehicles environmental rating and motor vehicle emissions within the framework of the Customs Union.

Kazakhstan's motor vehicle requirements are set at the Euro-2 level. Belarus produces vehicles (MAZ, BelAZ, MTZ tractors) without specifying any strict environmental standards. In 2010 Russia introduced Euro-4 grade requirements for motor transport. Russia is in talks with Kazakhstan on a two-year transition period for the production of Euro-2 grade fuel without the right to sell it in Russia from 2011. The Ministry of Internal Affairs will be responsible for the non-admission of motor transport that fall short of accepted standards to Russia's auto market.

Kommersant

Drafting of Customs Union regulatory framework enters the closing stage

May 19, 2010

Six weeks before the introduction of the single customs territory of Russia, Belarus and Kazakhstan into effect (elimination of inner borders and introduction of a common Customs Code starting July 1, 2010) the process of drafting the Customs Union regulatory framework entered its final stage. Three draft agreements on issues of pipeline transport, intellectual property, and customs charges for transit still need to be coordinated. The two more vital documents – a supranational Customs Code of the Customs Union and a draft law "On Customs Regulation in Russia", the successor to the domestic Code, are also on their way.

The draft law provoked debates in business circles. During a meeting with Vladimir Putin on May 17, the head of the Russian Union of Industrialists and Entrepreneurs Aleksandr Shokhin noted that the enactment of the draft law could impede business in Russia, in particular due to the presence of over 150 reference rules that refer to government resolutions, as well as delegation of decision-making authority to the customs services.

According to Russian Federal Customs Service, Russia is ready to transfer control from the Russian-Belarusian border to the external boundary of the Customs Union. The situation of Russian-Kazakh border is more complicated. Starting July 1, 2010, border control will be alleviated but remain in effect. Given the weak development of Kazakhstan's borders with neighbouring Kyrgyzstan and China, Russian authorities are uptight about a possible inflow of smuggled goods and drug trafficking from these countries. Therefore, the checkpoints on the border with Kazakhstan will remain in effect for an indefinite time.

The continuing efforts of Belarus to win the exemption from customs duties on Russian crude oil and oil products starting July 1, 2010 remain one of the unresolved issues.

Kommersant

Customs Union launched

July 5, 2010

The participants of the EurAsEC Interstate Council's meeting in Astana signed a declaration launching the Customs Union and a set of about 20 documents. Russia and Kazakhstan enacted the Customs Code of the Customs Union starting July 1, 2010, and on July 6, 2010 the Code comes into force in all the three countries.

Following the results of the Customs Union Commission meeting, the participants made decisions on implementation of the second stage of establishing the Customs Union; international agreements of the Customs Union on cooperation in criminal and administrative cases; export control of the Customs Union member states; the structure of the Customs Union Commission's Secretariat for 2011, and other international obligations of the Customs Union member states to be considered in the Customs Union decision-making.

The Customs union was to go into effect on July 1, but was delayed due Belarus' strong stand against export taxes Russia charged for its oil supplies to Belarus. Moscow said the oil tax would be waived on January 2012, when the three countries establish a full-fledged Common Economic Space.

RIA Novosti

Chronology of ratification of the Agreement on the Customs Code of the Customs Union

On May 21, the premiers of Russia, Belarus and Kazakhstan failed to harmonise the most sensitive issues that aroused between the countries during the formation of the Customs Union.

On May 28, Belarus refused to take part in the meeting on issues of the Customs Union, objecting to export taxes Russia charged for its oil supplies. During the meeting Russia and Kazakhstan signed an array of agreement on a bilateral basis.

On June 1, Belarus expressed its readiness to make concessions on an array of issues, sensitive to Kazakhstan and Russia.

On June 3, Russian President Dmitry Medvedev signed a federal law "On Ratification of the Agreement on the Customs Code of the Customs Union". Medvedev also signed a federal law "On Ratification of the Protocol on Introduction of Amendments and Additions to the Agreement on the Customs Code of the Customs Union dated November 27, 2009".

On June 4, the Parliament of Belarus ratified a package of documents and agreements on issues of the Customs Union, including the principles of levying indirect taxes in the export/import of goods, regulating the relations of the three countries in the turnover of the products that are subject to compulsory conformity assessment, as well as the hygiene and veterinary control.

On June 8, the Agreement on the Customs Code of the Customs Union was passed to the house of representatives of the National Assembly of Belarus for ratification.

On June 11, Belarusian President Alexander Lukashenko met with the Russian President Dmitry Medvedev and Prime Minister Vladimir Putin to discuss the issues related to the establishment of the Customs Union and the Common Economic Space, as well as oil and gas deliveries.

On June 14, the Parliament of Belarus postponed ratification of the Customs Code.

On June 25, Kazakhstan's President Nursultan Nazarbayev signed a law "On ratification of the Agreement on the Customs Code of the Customs Union".

On July 6, the Customs Code of the Customs Union was put into force by all the three states – Russia, Kazakhstan and Belarus, with the corresponding declaration being signed during the EurAsEC summit in Astana.

RIA Novosti, RBK

Major changes introduced with enactment of Customs Code

July 12, 2010

The key novelty, introduced by the Customs Code of the Customs Union, is the cancellation of the customs borders between the three states. Customs control will be carried out on the external borders of the Customs Union member states, and customs clearance procedures on Russian-Kazakh and Russian-Belarusian borders will be simplified. Customs terminals will be abolished by July 1, 2011.

The formation of the single customs territory will result in free movement of goods and labour force, liberalisation of mutual trade and abolishment of customs duties. It is expected that unified duties and quotas will be applied to goods from non-Union countries, and that mutual trade between the three states will be free from import duties, restrictions and exclusions, with zero VAT rate and excise taxes.

The members of the Customs Union are only unifying customs legislation - civil, banking and tax legislation remains separate for each country.

With the introduction of the new Customs Code, the time permitted to pay customs duties and taxes has been increased from 15 days to 4 months. The time span for post-customs control was prolonged from one to three years. Customs declaration now has to be registered or denied registration within two hours from the moment of its submission. The new Code excludes verbal and implied avowal (crossing the border in the "green corridor").

Ordinary travellers are also affected by the new Customs Code for it foresees the increase in duty free import rates from 35 to 50 kg, and lowers the total value of duty free goods from 65,000 roubles to around 57,000 roubles (€1,500).

Vlast' Magazine, *Vedomosti*

Customs Union to establish its own unified court

November 26, 2010

The Customs Union Commission suggests establishing a unified court of the Customs Union of Russia, Belarus and Kazakhstan.

It is expected that the representatives of the Customs Union member states, working in the CIS Court and the EurAsEC Court, would make decisions within the framework of the Customs Union Court.

The EurAsEC Court operates within the framework of the CIS Court with the same judges making decisions for the five states. The Customs Union Court would be established within the EurAsEC Court, in order not to increase the number of judges. The heads of governments of Russia, Belarus and Kazakhstan supported the idea.

A first experts' council will also be established within the Customs Union Commission. It will be formed of five representatives from each of the three states, legal advisers on customs matters, international affairs and trade. The experts' council will also deal with complaints filed by business representatives against the Customs Union Commission's decisions.

Kursiv

Sectoral Issues surrounding the Customs Union

Advantages of sector alliances within Customs Union

May 17, 2010

Agriculture Minister of Belarus, Semyon Shapiro, and the chairman of Russia's National Union of Milk Producers Soyuzmoloko, Andrei Danilenko, agreed to establish a union of Russian and Belarusian manufacturers of dairy products. The association will pursue the interests of milk producers of the two countries, elaborate common approaches to pricing and the product quality control. In addition, it will be a good opportunity to join efforts against unfair competition and unauthorised supplies of goods. According to Danilenko, Soyuzmoloko is currently studying an opportunity of establishing a similar alliance of dairy products manufacturers with Kazakhstan.

Kommersant

Russia, Kazakhstan close first deal within the framework of Customs Union

July 1, 2010

According to Magnitogorsk customs office of Ural customs administration, the first customs-free shipment from Kazakhstan successfully crossed the Russian border on July 1. A rail shipment of 700 tons of Kazakhstan's wheat was delivered to Makfa, a Russian manufacturing enterprise situated in Chelyabinsk.

Kazakhstan Today

Russia bans free movement of alcohol production within the Customs Union

August 25, 2010

Russian Federal Customs Service takes steps to prevent imports of alcohol production from the Customs Union member states. Last week, following the instructions of Rospotrebnadzor, the Federal Customs Service banned imports of Moldovan and Georgian wines and cognacs from the territories of Belarus and Kazakhstan.

According to the Federal Customs Service, the agreement on common customs borders for the Union does not alter the provisions of the federal law "On State Regulation of Production and Turnover of Alcohol". It requires clearance of alcohol when crossing Russia’s borders and prohibits selling alcohol in Russia without being labelled with Russian excise stamps.

Therefore, manufacturers and distributors of alcohol products from Belarus and Kazakhstan will not be able to make use of the Customs Union and are supposed to clear their goods on a par with importers from all other countries.

RBK Daily

Customs Union to receive its own system of unified technical regulations

September 30, 2010

The participants of the forum Customs Union 2010: First Results and Prospects were informed that the presidents of the Customs Union member states may sign an agreement on unified principles and rules for technical regulation in the nearest future. The document will foresee the establishment and use of unified technical requirements for the goods (production facilities, manufacturing process, storage, transportation, sales, utilisation, etc.) that are produced in Russia, Belarus and Kazakhstan. According to the draft agreement, the provisions of the unified technical regulations will have a direct effect in the three countries. As soon as unified technical regulations of the Customs Union come into force, the national requirements will become inoperative. A single information system will also be established within the framework of the Customs Union. It will provide consumers with the ability to check the compliance of the purchased goods with the technical regulations. The unified technical regulations will be based upon the CIS system of interstate standards (GOST). Introduction of unified standards will lower the likelihood of conflicts between the three states, and secure equal competition between the manufacturers on a single product market with regard to requirements for goods.

The unified technical regulations may be put into effect in 2012.

RBK Daily

Kazakhstan’s businesses report problems with access to Russian market due to the Customs Union

November 1, 2010

At a round-table discussion The Customs Union: from Theory to Practice held in Astana on November 1, 2010, Kazakh manufactures reported that in the 10 months of the Customs Union being in force Russian imports to Kazakhstan grew while entry barriers to the Russian market increased. They suggest that an introduction of a moratorium on sovereign law-making in the field of technical regulations may help establish an equal partnership.

According to the Tax Committee of Kazakhstan's Finance Ministry, in the period from July 1 to October 20, 2010, the number of importers grew by 14% and amounted to 7,682 importers from Russia and 667 from Belarus. Meanwhile, local producers noted the emergence of more barriers to entering the Russian market. A unified certificate posed lots of questions. At present the Customs Union member states have a common list of 205 types of products that are subject to obligatory certification. The rest of the products (2,500 in Russia, 1,500 in Belarus and 812 in Kazakhstan) are certified according to national regulations. A draft agreement on the introduction of unified principles and rules for technical regulations will address other issues within the framework of the Common Economic Space.

The participants of the round-table touched upon the rise in railway tariff on the part of Russian Railways by adding VAT.

Defining the customs value of goods remains a serious problem. Several provisions of the agreement on defining the customs value within the Customs Union appeared to be in conflict with the Agreement on the Customs Value between WTO member states. Necessary adjustments will be made in the short term, during the meeting of heads of customs services of the Customs Union member states.

Kursiv

SCO

SCO gets ready for enlargement

June 11, 2010

The 10th Meeting of the Shanghai Cooperation Organisation (SCO) took place in Tashkent, the capital of Uzbekistan, on June 10-11, 2010. The heads of the six SCO member states signed a package of documents, including the regulations on procedure for admitting new members to the SCO. Those countries applying for SCO membership (including Iran, Pakistan and India) have long awaited the approval of these documents.

Common approaches of the SCO Member States to the situations in Afghanistan and Kyrgyzstan were reflected in the Declaration of the 10th Meeting of the Council of the Heads of the Member States of the SCO, signed by Russia, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and China. The SCO member states confirmed their principle position on mutual support of the state sovereignty, the independence and territorial integrity of Kyrgyzstan, spoke against interfering in the country's internal affairs and expressed readiness to offer support and assistance.

The Regulations on Procedure for Admitting New Members to the Shanghai Cooperation Organisation play a strategic role. Given the organisation's criteria, the most probable applicants for the SCO membership are India, Pakistan and Mongolia, which already have observer status. In order to boost their status in the organisation, all countries need to file a corresponding application, which would be studied by the six SCO member states. The final decision will be based on a consensus of opinions. If any one of the six countries speaks against admitting a new member, the candidate country would be refused membership in SCO.

www.sectsco.org

SCO to establish interaction framework in field of agriculture

October 26, 2010

Beijing hosted the first meeting of agriculture ministers of the six SCO member states. The heads of the agricultural ministries discussed the issues of establishing multilateral cooperation in the field of agriculture and its development prospects. The parties confirmed that at the current stage of developing agricultural cooperation in the SCO framework priority attention will be paid to implementation of joint projects in the areas outlined in the Agreement on Cooperation in Agriculture, facilitation of agricultural trade and investment.

www.sectsco.org

Results of SCO summit in Dushanbe

November 25, 2010

Dushanbe hosted a regular Meeting of the Council of the Heads of Governments of the Shanghai Cooperation Organisation Member States. Delegations from the SCO member states exchanged opinions on the current political and economic situation, as well as issues of stability and security in the SCO region. The participants of the meeting also discussed state and prospects for developing trade and economic cooperation within the framework of the SCO. Kyrgyzstan expressed gratitude to the SCO member states for the humanitarian assistance.

The heads of governments expressed an intent to further strengthen cooperation in customs services, improve customs, administrative and transport procedures, as well as develop electronic commerce.

During the meeting, Kazakhstan's Prime Minister, Karim Masimov, suggested establishing a joint regional digital network that would aid SCO member states in speeding up customs clearance of cargoes and developing of an SCO high-speed information highway.

The participants of the meeting voiced the need to facilitate the interaction with the SCO Observer States and Dialogue Partners in implementing joint projects in the areas of high technology, agriculture and transport, as well as developing investment cooperation to assist the needs of mutual development and prosperity in the region.

Chinese Premier Wen Jiabao called for deepening financial and monetary cooperation among the SCO member states, noting that they should expand business financing channels, conduct research into the establishment of an SCO development bank, discuss new ways of joint financing and joint benefiting, and expand cooperation on local currency settlement to promote regional economic and trade exchanges.

www.sectsco.org, Kursiv

BILATERAL COOPERATION

Russia–Georgia

March 2, 2010

In late 2009, under the Swiss mediation Georgia and Russia agreed to reopen their land border to traffic. The Upper Lars Checkpoint, a border crossing between Russia and Georgia that was closed in 2006, was reopened on time. However Russia refused to restore a visa-free regime. Therefore, the citizens of Russia and Georgia who intend to pass the Upper Lars-Kazbegi checkpoint should apply for a visa to Swiss Embassies in Tbilisi and Moscow, as Switzerland acts as mediator in the process. The citizens of other CIS countries still enjoy a visa-free border crossing. The Upper Lars Checkpoint will reach its full daily capacity of 7,000 people, 50 buses and 900 motor vehicles by summer 2010.

Kommersant

Georgian airline gets permit to fly to Russia

May 18, 2010

Russia's Transport Ministry has allowed a private Georgian company, Airzena Georgian Airways, to fly direct charter flights between Tbilisi and Moscow from May 24 till June 9, 2010.

RIA Novosti

Note: Russia cut regular direct flights with Georgia in October 2006, following the deterioration in relations between the two countries. The flights were restored in late March, 2008, but were again suspended after the August war. Russia's Transport Ministry allowed Georgian Airways to run nine charter flights between the two capitals in early January and April this year during the New Year and Easter holidays.

Russia–Kazakhstan

Baikonur lease extended to 2050

March 4, 2010

Majilis, the lower house of Kazakhstan's parliament, ratified an agreement extending Russia's lease of the Baikonur spaceport until 2050. Among other things, the document envisages the development and construction of a promising environmentally friendly space missile complex Baiterek at Baikonur, based on Russia's Angara complex.

On March 11, the Roskosmos head, Anatoly Perminov, expressed his discontent with the provisions of the agreement, which, in his opinion, limit Russia's role and participation in international space cooperation.

Note: The governments of Russia and Kazakhstan signed the Agreement on the lease of the Baikonur spaceport on December 10, 1994 in Moscow. Russia pays a total of $115 million a year.

Russia is developing a separate Vostochny spaceport in the Amur region set to open in 2015. The new facility aims to rival Kazakhstan's Baikonur launch site and may lead to early lease termination. However, Russia cannot abandon Baikonur at present due to existing international obligations to implement various space programmes. Additionally, missions to the ISS are launched exclusively from Baikonur due to advantages of its geographic location.

Kursiv

Russia–Ukraine

New scheme for Russian–Ukrainian relations

March 25, 2010

A meeting of the prime ministers of Russia and Ukraine, Vladimir Putin and Nikolay Azarov, was held in Moscow. The Ukrainian delegation offered a packet agreement on the establishment of a gas transportation consortium of companies from Russia, Ukraine and the EU for managing the Ukrainian Gas Transport System in exchange for a substantial discount in price for Russian gas.

However, Moscow is neither willing to lower gas prices nor is it ready to regard the participation in gas transportation consortium as a reason for gas price-cutting.

The premiers touched upon other issues as well. Russia wants the Ukrainian government to guarantee the protection of Russian business interests in Ukraine, and intends to initiate a review of a repartition of property, which took place in Ukraine after the "orange revolution".

Russia is also interested in the project to construct a nuclear fuel production facility. Ukrainian president Viktor Yanukovich instructed the government to study this issue and discuss the possibility of Russia's participation in building three power units at a nuclear power station.

Moreover, the countries are studying the possible amalgamation of Russian and Ukrainian aircraft industries.

Kommersant

Russian president pays first official visit to Ukraine

May 17, 2010

The President of Russia, Dmitry Medvedev, paid an official visit to Ukraine. Earlier in the course of Medvedev's visit to Kharkov a set of so called "Fleet-for-Gas" agreements was signed between Ukraine and Russia.

On May 17, the respective ministries of Russia and Ukraine signed agreements on border demarcation, use of GLONASS satellites system, as well as cooperation in science and education.

The presidents signed three joined statements on issues of European security, the Transdniestria conflict settlement and the Black Sea region's security issues.

Economic projects discussed in Kyiv may lead to large-scale agreements. However, the merger of Gazprom and Naftogaz could become the most important project. On May 17, the presidents of Russia and Ukraine touched upon this issue for the first time.

Ъ-Online, RBK Daily

Note: The border between the two states in the Kerch strait linking the Sea of Azov to the Black Sea has been a bone of contention between the two countries since the collapse of the Soviet Union. Ukraine unilaterally established a maritime border with Russia in the 1990s, saying it was based on the Soviet-era administrative border between the two republics. Russia has repeatedly denied the existence of Soviet administrative borders and called for shared use of the Kerch Strait. Russia suggests dividing the seabed of the Azov Sea, while the two countries should jointly use the water area, however, Ukraine opposes the idea.

Presidents of Russia and Ukraine fail to settle gas and borders issues

November 26, 2010

A meeting between the Russian and Ukrainian Presidents, Dmitry Medvedev and Viktor Yanukovich, was held at the Gorki residence. The heads of states signed seven documents, including an intergovernmental agreement on cooperation in the field of transporting oil to Ukrainian refineries and transiting it via the Ukrainian territory that will increase Russia's oil transit to 18.5 million tons. However the presidents didn't manage to reach agreements on such important issues as a possible discount in gas price for Ukraine, plans for establishing a joint venture between Russian Gazprom and Ukrainian Naftogaz, as well as settlement of disputes concerning the delimitation of the Azov-Kerch Strait.

Kommersant

Russia–Tajikistan

Problematic issues in Russian–Tajik relations

August 19, 2010

The presidents of Russia, Afghanistan, Pakistan and Tajikistan took part in a four-party summit in Sochi. The summit focused on the situation in Afghanistan, as well as drug trafficking and a terrorist threat coming from this country.

Within the framework of the summit, Dmitry Medvedev met with Emomali Rakhmon to discuss several issues. In particular, Tajikistan is willing to cooperate with Russia's Inter RAO UES in the construction of several hydropower plants. Furthermore, Tajikistan asks Russia to lower tariffs on its deliveries of oil products. Russia is ready to discuss the proposals but only on condition of Tajikistan's fulfilling its old obligations, including the repayment of an energy debt of $20 million to the Russian companies in Sangtuda-1 HPP holding. The long standing issue in Russian-Tajik relations is the problem of deploying Russian air force at Gissar air facility near Dushanbe. According to an agreement dated 2004, Russian pilots and aviation equipment were to be transferred to Gissar from Dushanbe civilian airport. However, Tajikistan violated its obligations and five Su-25 battle planes were relocated to the Kant base in Kyrgyzstan.

Note: several more claims took place in the history of Russian-Tajik relations:

- *September 2007 – Tajik authorities denounced an agreement with Russia's UC RUSAL on the completion of the construction of Rogun HPP. The company was accused of upholding Uzbekistan's interests after it refused to construct a 325 m high dam, which would have allowed the region's water resources to be controlled.*
- *March 2009 – Tajikistan stopped the broadcasting of RTR-Planeta TV-channel on its territory, referring to an unpaid debt of All-Russian State Television and Radio Broadcasting Company VGTRK for 2008 at an amount of $7 million. The debt was repaid but broadcasting didn't resume as Tajikistan raised retranslation tariffs 50%.*
- *July 2009 – Tajik authorities demand that Russia pays $307 million per year for leased facilities (201 military bases, real estate and land). Meanwhile, according to a bilateral agreement, rent for military basis is not provided for until 2014. Tajikistan renounces its claims only in October 2009, prior to Emomali Rakhmon's visit to Russia.*
- *Summer 2009 – Tajikistan refuses to sign acceptance certificate for the Sangtuda-1 HPP, constructed by Russian companies. Without a certificate, Russia is unable to raise HPP tariffs to the market rate and demand that Tajikistan pays its share in the project. The Tajik party signed the document on July 31. However, Barki Tochik state company was soon unable to pay for energy, which led to a debt of $30 million.*
- *October 20, 2009 – During the meeting with Russian Energy Minister Sergey Shmatko, Tajik President Emomali Rakhmon criticised Gazprom activities in the country. According to the Tajik President's press office, discontent was caused by the fact that "Gazprom was developing only one out of the four gas deposits transferred to the company".*

Moscow is also ready to make concessions to Tajikistan and reduce tariffs on those oil products that are supplied for Tajikistan's domestic use. Taking into account Tajikistan's practicing a scheme of reselling oil products, similar to the Belarus, Russia asked for documents verifying the supply and consumption balance.

Kommersant

Problematic issues in Russian–Tajik relations settled

November 26, 2010

Dushanbe hosted the meeting of heads of governments of the Shanghai Cooperation Organisation. In parallel to the summit the Prime Minister of Russia Vladimir Putin and the President of Tajikistan Emomali Rakhmon held bilateral talks that resulted in settling problematic issues between the two states, from repayment of energy debts to the deployment of Russian servicemen. The broadcasting of RTR-Planeta TV-channel was resumed. On September 7, the countries signed an agreement on settling the debt for Sangtuda-1 HPP energy. Tajikistan acknowledged the $20 million debt and started the repayment. Inter RAO UES also benefited from this agreement as it paved the way for the construction of new hydropower plants. The sides made significant progress in settling the issue of redeploying Russian pilots to Gissar air facility.

The final decision may be taken in 2011, together with the resolution on the status of Russian border guards.

In addition to this, Putin conducted negotiations with Kyrgyz President Rosa Otunbayeva to discuss economic assistance to the country (in particular, the abolition of duties on oil products starting January 2011).

Ъ-Online

Russia–Belarus

Belarus raises transit tariffs for oil products

January 1, 2010

According to the Economy Ministry of Belarus, from January 1, 2010 the specific tariff for transiting oil products through the territory of Belarus will be increased by 4.4% to $1.42 per ton per 100 km. A corresponding resolution was adopted in line with the Belarusian-Russian intergovernmental agreement on cooperating in the operation of main oil product pipelines located in Belarus, dated June 8, 2004.

On January 1, 2009, transit tariffs for oil products were increased by 52.8% to total $1.36 per ton per 100 km. The transportation of Russian oil products through Belarus' territory is carried out by Zapad-Transnefteproduct (a subsidiary of Russian Transnefteproduct).

RIA Novosti

Dispute over oil supplies and transit continues

January 4, 2010

Russia and Belarus, having entered the year 2010 without a new contract on oil supplies and transit, continue talks. Oil transits to Europe and oil supplies to Belarusian refineries continue as well.

According to a Belarusian state group of companies, Belenergo, an interruption of Russian electric power to Kaliningrad region is possible due to unconcerted transit conditions. However, the Belarusian side have noted that this issue is not interrelated with negotiations on oil supplies and transit.

RIA Novosti

Russia and Belarus agree on oil supplies

January 27, 2010

Russia and Belarus have signed an array of agreements on crude oil deliveries. According to a joint statement by the Russian deputy prime minister Igor Sechin and Belarusian first deputy premier Vladimir Semashko, the parties also signed a statement pledging uninterrupted oil transits to Europe.

Previous agreement on oil supplies to Belarus expired in late 2009. Oil duties became a bone of contention between the two countries. Oil deliveries from Russia to Belarusian refineries were cut by 40% to 19,000 tons a day because Belarus made a prepayment based on a 2009 preferential duty, which constitutes only 35.6% of the standard oil duty (around $380 per ton). However, Russia demands the full oil export tariff be taken into account, which would lead to a price increase to $570 per ton. A decree of Russian Federal Customs Service on adding a standard oil export duty to the price for Russian oil and oil products, supplied to Belarus, came into force starting January 2. Russia earlier offered to supply Belarus with some 6.3 million tons of oil for domestic consumption duty-free and demanded Minsk pay full import duties on crude it refines and transits to Europe, dropping considerable subsidies. Belarus refused and made a proposition that Russian companies supply oil to Belarus duty-free in January-February and jointly work out a mechanism of intergovernmental distribution of duties within the framework of the Customs Union by early March.

Ъ-Online

Belarus offers assets in exchange for gas

February 10, 2010

Belarus offered Gazprom a share in the project on the construction of a combined cycle gas turbine power unit at Berezovskaya GRES with capacity of 400-500 mW at a total cost of $490 million, as well as the construction of a new chemical plant on the basis of the Grodno Azot company. In exchange, Belarus asks for a decrease in gas price for 2010 to the level of 2009, i.e. $150 per 1,000 m^3. Currently, Belarus purchases gas for $168.8 per 1,000 m^3.

If Gazprom agrees to the proposal, the company may lose $394–414 million in revenues from the delivery of 21-22 billion m^3 of gas to Belarus in 2010. Starting from 2008, the gas price for Belarus is being calculated every three months at a formula that is tied to the oil price.

The Belarusian proposal is basically of interest to Gazprom. For instance, the Grodno Azot project foresees the construction of a new “three-in-one” chemical plant for production of ammonia, methanol and carbamide. The plant will make it possible to process up to 600 million m^3 of natural gas a year. However, the project demands investment of $1.5 billion in the next six years. Gazprom has repeatedly tried to acquire Grodno Azot in exchange for Belarusian gas debts; however the president of Belarus, Alexander Lukashenko, has been cancelling negotiations on the grounds of unfavourable conditions for the asset sale.

Expert Online

Protocol on oil supplies ratified, Belarus unhappy with the introduction of export duty on Russian oil

February 12, 2010

The President of Belarus, Alexander Lukashenko, signed a decree to approve a protocol on amendments to the Belarusian-Russian intergovernmental agreement on measures for regulating trade and economic cooperation in the export of oil and oil products dated January 12, 2007.

In line with the document, Belarus can import zero-duty Russian oil in an amount sufficient for domestic consumption. The amount has been set at 6.3 million tons for 2010. The duty for any amounts of oil above of the agreed figure will be set in accordance with the Russian law. The Russian State Duma ratified the protocol on oil supplies to Belarus a little earlier on February 12.

February 16, 2010

Soon after the ratification of the agreement on Russia's oil supplies to Belarus, Minsk accused Russia of breaking its obligations on establishing the Customs Union by introducing oil export duties starting January 1, 2010. Minsk advocates the mechanism of a duty-free trade within the Customs Union with a following intergovernmental distribution of duties, applied on the external border of the Customs Union.

Ъ-Online

Positions of parties in Russian–Belarusian talks have not changed

March 16, 2010

Russian Prime Minister Vladimir Putin held talks with his Belarusian counterpart Sergei Sidorsky to discuss bilateral relations and integration initiatives. The premiers exchanged opinions on the current economic problems, including the balance of fuel and energy resources for 2010. Vladimir Putin reaffirmed Russia's position to lift duties with the establishment of a single economic space on January 1, 2012.

Russian Prime Minister advocates Russia's and Belarus' transit to a single currency. According to Putin, a single currency could give an impetus to the market participants, simplify mutual settlements and minimise expenditures of the economic agents.

RBK Daily, Finam.ru

Russian power transit via Belarusian UES again under threat

March 23, 2010

Transit of Russian electric power via the Belarusian Unified Energy System to the Baltic States and Russian enclave of Kaliningrad is again under threat, this time for technological reasons.

The Belarusian State Energy Company Belenergo dragged out repairs of the 750 kW trunk transmission line, which is used for transiting Russian electric power to the Kaliningrad region. Currently, the energy is being supplied via 330 kW power lines that have an adverse effect on the amounts of electric power transited to Kaliningrad and the operational reliability of the south part of Russia's "Centre" integrated power system, as well as the scheme of power distribution of Smolensk nuclear power plant (NPP). The 750 kW trunk transmission line interconnects the Smolensk NPP with the 750 kW Belorusskaya power substation and plays an important role in securing a sustainable parallel operation of power grids of Belarus, Russia, Estonia, Latvia and Lithuatnia (BRELL), which are parties to an agreement on parallel operation.

Expert Online

Note: Russia and Belarus have been discussing the amount of oil to be supplied to Belarus duty-free starting early 2010. On March 17, the Prime Minister of Russia Vladimir Putin agreed that with the introduction of a single customs territory all duties should be abolished. However, Putin reminded that the single customs territory would not be put into force until 2012. Until then, Russia is ready to supply Belarus with 6.3 million tons of duty-free oil for domestic consumption. However on March 25, Belarus announced that they have filed a suit against Russia in the CIS Economic Court, requesting an assessment of the legality of the customs duties on oil products and crude oil that Russia supplies to Belarus. On June 24, the court dismissed a request from Belarus that Russia be prohibited from levying export duties on oil products until the end of the dispute.

Belarus, Russia given time for out of court settlement of oil dispute

September 7, 2010

The CIS Economic Court has suggested that Belarus and Russia should try to find an out of court settlement of their dispute regarding the legality of Russia's collection of customs duties for the oil products Belarus buys.

The next session of the CIS Economic Court will take place on October 7, 2010. By that time the court expects Belarus and Russia to reach an out of court settlement of their dispute.

Ъ-Online

Russia, Belarus agree on transport control in Union State

October 5, 2010

The Transport Ministers of Russia and Belarus, Ivan Shcherbo and Igor Levitin, signed an agreement in Minsk, which cancels the control of the road transport on the common Belarusian and Russian border and moves it to the outside borders of the Union State of Belarus and Russia. The countries plan to establish a unified technological base for road transport monitoring and invite Kazakhstan to join, which would allow the control of transport flows from China to Europe.

Note: The agreement was signed in the context of a continuing deterioration of Belarusian-Russian relations. Russian President Dmitry Medvedev noted that the head of Belarus Alexander Lukashenko attempts to make an enemy out of Russia in response to Lukashenko's statements at his meeting with Russian journalists, when he criticised Russia's leadership and accused Moscow of trying to oust him from the presidency.

The document will give a new impetus to the development of transport systems. According to the statistics, 400,000 cars that cross the Belarus-Poland border are transit to Russia.

Russia and Belarus also developed a project for uniting transport infrastructures in 2011-2012.

Ъ-Online

TRADE AND INVESTMENTS

Importers of alcohol request to postpone Customs Union regulations

January 13, 2010

The establishment of the Customs Union posed serious problems to the Russian alcohol market. The agreements of the Customs Union member states on the common rules of licensing in the sphere of foreign trade and the list of goods that are subject to obligatory licensing came into effect starting January 1, 2010. According to the agreements, imports and exports of strong drinks and wine are subject to licensing. Customs clearance of wine was fully stopped on January 11, because the importers didn't have the required licenses. Local branches of Industry and Trade Ministry were responsible for issuing licenses starting January 1; however, they began to accept applications later and the process of receiving licenses still needs to be adjusted. In its official statement the Industry and Trade Ministry noted that the process of issuing a license takes up to two weeks.

The Customs Union member states agreed upon a common list of products that are subject to restrictions when being imported from non-Union countries and require obligatory licensing starting January 1, 2010. Ethyl alcohol and alcoholic beverages - excluding vodka, tequila and some other strong drinks – were previously exempted from licensing and then included in the common list of goods, which led to a halt in customs clearance of alcohol starting January 11.

January 18, 2010

The eleven largest importers of alcoholic beverages filed an appeal to Russian Prime Minister Vladimir Putin and the head of the Federal Customs Service Andrei Belyaninov to postpone the commencement of the Customs Union regulations, which limit wine imports, for six months. According to experts, the current situation is damaging not only to importers, but also to the local producers of wine, because 70% of wine materials for still wines and 100% of materials for champagne are imported from abroad. According to estimates, the participants in the alcohol market will lose $300 million in revenue.

January 19, 2010

The Federal Customs Service has informed of "conditional clearance" of alcoholic beverages to the territory of Russia "to reduce the time of customs clearance" in case the importers provide a document certifying the appeal for a license is filed with the Ministry of Industry and Trade. However, "conditionally cleared" goods could not be sold until the completion of customs clearance procedure, i.e., license acquisition. Overall, the market is in need of tens of thousands of licenses. A temporary import permit allows importers to transport goods to their warehouses and cut expenses for customs temporary storage warehouses. However, according to the market participants, these expenditures are insignificant, compared to overall losses due to the import suspension.

RBK Daily, Vedomosti

Protocol on establishing Eurasian Stock Union signed

February 18, 2010

The Customs Union member states would have another common territory. The heads of commodity exchanges of Belarus, Russia and Kazakhstan signed a protocol of intent to establish the Eurasian Exchange Union, a new common trading floor for trading in agricultural production and raw materials from the member states.

The Belarus Universal Commodity Exchange, Moscow stock exchange and International commodity exchange of Kazakhstan will act as shareholders of the new Eurasian Exchange Union. The chairman of the board of the Belarus Universal Commodity Exchange, Arcady Salikov, will represent the interests of commodity exchanges in the EurAsEC bodies.

Mirtv.ru

Trade protection brings billions in losses to Russian exporters

March 1, 2010

Russian exporters lost around $2.04 billion last year due to measures restricting supplies of their products to external markets. According to the Trade Negotiations Department of Russia's Economic Development Ministry, 23 countries, from Australia to Uzbekistan, apply a total of 98 restriction measures to Russian goods. As of early February 2010, Russian goods faced 40 antidumping measures, 11 special safeguards and 47 measures for nontariff trade regulation, including administrative control measures. Moreover, four antidumping and four special safeguards investigations are being carried out, as well as five re-examinations of earlier antidumping measures. The bulk of restriction measures applied to Russian goods are registered in Belarus (23), the EU (17), Ukraine (10) and the USA (9). The main trouble spots for Russian exports are the markets of the EU, Mexico, Australia, the USA, India, Kazakhstan, Uzbekistan, Belarus and Ukraine.

More than half of antidumping measures apply to Russian ferrous metals. The second place goes to mineral fertilisers and chemicals.

The actions of Russian Economic Development Ministry resulted in abolition of 26 restriction measures that impeded access of Russian goods to external markets in 2009.

RBK Daily

Russia, Belarus and Kazakhstan compete for trade flows

March 24, 2010

Competition between Russia, Kazakhstan and Belarus for future trade flows in the single economic space within the framework of the Customs Union topped the agenda of a meeting of Russian government's presidium.

The Russian government raised concerns that European companies will use Belarus as a springboard to the 180 million market of the Customs Union. First of all, customs regulations in Belarus are much simpler. Secondly, Belarus developed processing industry as early as in Soviet times and served an outpost for promoting soviet goods to Europe. If Belarus institutes a more simple and transparent conditions on the external boundary, this could have a serious influence on the overall trade flow. The preferable customs conditions of Kazakhstan and Belarus may attract businessmen who would transfer the supply chains to areas with more transparent and easy-to-understand customs procedures.

Russia intends to compete for transit. According to the Economic Development Ministry, the customs control procedure in Russia often becomes a reason for large-scale expenditure by foreign partners, has a negative influence on the country's investment image and needs to be simplified.

RBK Daily

ECONOMIC SECTORS

Oil and Gas

Gazprom to buy gas from Azerbaijan in 2010

January 11, 2010

Gazprom chairman Alexei Miller held a meeting to discuss main performance indicators for the first ten-day period of January. According to the company's leadership, the beginning of 2010 was marked by an important event – for the first time ever, Gazprom bought gas from Azerbaijan. In 2009, the company held a series of constructive talks with the Azeri colleagues and within several months after signing an agreement Gazprom began pumping Azeri gas. Common boundary and operational gas transportation infrastructure create conditions for mutually beneficial

Note: On October 14, 2010 Gazprom and the State Oil Company of Azerbaijan (SOCAR) signed a sale-and-purchase contract for Azerbaijan's gas for 2010-2015 with the option to prolong the agreement. In January Gazprom and SOCAR agreed to increase purchases of Azeri gas to 1 billion m^3 in 2010 and up to 2 billion m^3 in 2011. Azerbaijan's proven reserves of natural gas amount to around 1.5 trillion m^3, while the country's consumption makes up 12-14 billion m^3 a year.

cooperation in the sphere. The parties didn't specify a ceiling value for gas purchases. Gasprom will buy as much gas as Azerbaijan can supply.

March 9, 2010

Azerbaijan doubled daily supplies of gas to Russia. According to Gazprom's head, Alexei Miller, starting March 5, 2010 the amount of gas supplies from Azerbaijan increased twofold to 3 million m^3 per day.

Kommersant, RBK Daily, Finam.ru

Oil transit via southern branch of Druzhba pipeline halted

February 9, 2010

Kazakhstan has halted Urals crude oil supplies to Slovakia and Hungary via the Druzhba pipeline amid a trade dispute with Ukraine, prompting Russian oil company LUKoil to intervene to compensate for the loss.

In January-March 2010 Kazakhstan was to transit 1.356 million tons of oil via the southern branch of Druzhba pipeline, including 756,000 tons to Slovakia and 600,000 tons to Hungary. In January, Kazakhstan supplied around 340,000 tons of oil to Slovakia, while no deliveries were made to Hungary and Poland. As of February 8, Kazakhstan halted oil transit to these countries. On this account LUKoil rerouted some 300,000 tons of Russian export blend Urals scheduled for loading from the Polish port of Gdansk in February to Slovakia and Hungary. In turn, Kazakh oil will be transported via the northern branch of the Druzhba pipeline to the port in Gdansk.

Traders said the development followed a move by Ukraine to scrap a crude transit deal with Kazakhstan for 2010 in retaliation for Kazakhstan suspending crude deliveries via Ukraine's Odessa Black Sea port last year.

Urals crude transit via Odessa stopped in late 2009 after Ukrtransnafta reversed the branch of Kremenchug-Odessa pipeline to supply the Kremenchug Refinery. Ukrtransnafta suggested Kazakhstan a longer transit route that led to increase in transit fees.

Reuters

Ukraine and Kazakhstan agree to resume oil transit via Druzhba pipeline

September 16, 2010

The presidents of Ukraine and Kazakhstan met in Kyiv on September 14, 2010 and agreed upon the resumption of oil transit via Druzhba pipeline at an amount of 6 million tons and a further 2 million tons for Ukrainian refineries a year.

Kazakhstan suspended oil transit to Europe via Ukraine in February 2010 after Kyiv changed the currency it charged for transit tariffs from U.S. dollars to euros, which has resulted in a 20-25% increase in charges. In light of this, Kazakhstan switched its oil transit to a more economically beneficial route through Poland. As a result, oil transit through Ukraine decreased by 23.9% to 17.2 million tons.

Ukraine wishes to begin talks with the Russian Energy Ministry on transiting Kazakhstan's oil through its territory to Ukraine in the near future.

On September 17, 2010, the managing director of Kazakhstan's KazMunayGas, Nurtas Shmanov, announced that Ukraine's transit fees remain unfavourable to Kazakh companies and at present there are no oil deliveries through Ukrainian territory. The difference in transit fees from Kazakhstan through Belarus to Poland (to Adamova Zastava) and through Ukraine to Slovakia (to Budkovce) amounts to $5.2 per ton or $13.6 million a year in additional expenses to Kazakh companies.

KazMunayGas' managing director mentioned that he is not familiar with the details of agreements reached by the presidents of the two countries, Viktor Yanukovich and Nursultan Nazarbayev, during their meeting in Kyiv.

Kursiv

New routes for transportation of Kazakhstan's oil

March 3, 2010

Kazakhstan is interested in the construction of a new oil pipeline to Europe, which will go through the territory of Caucasus and link to Constanta-Trieste Romanian pipeline, Kazakh president Nursultan Nazarbayev said after the meeting with his Romanian counterpart Traian Basescu.

The presidents of both countries gave instructions to the relevant oil companies to study the issue.

In this case, Romania plays the role of Kazakhstan's take-off area for Europe. Kazakhstan supplies Europe with 4 million tons of oil a year, which is one third of Romania's total exports. Moreover, Kazakhstan's KazMunayGas is the 100% owner of Romanian Rompetrol, which has its own refinery and a sales network of 900 gas stations in six European countries. Romania is currently in talks with Italy on the project for construction of Constanta-Trieste oil pipeline, which would be used to transit Kazakh oil if the construction project is approved. At present Kazakhstan produces 70-80 million tons of oil per year, the bulk of which is being transported to Russia. Around 10 million tons go to China and 10 more million tons are transported to Baku via the Baku-Tbilisi-Ceyhan oil pipeline. In 2013, Kazakhstan intends to commence a large-scale oil production on one of the world's largest oil fields, Kashagan. This would give Kazakhstan an annual "export supplement" of 50 million tons. Kazakhstan believes that Kashagan's reserves exceed the capacities of Russian Transneft, Russian-Kazakh CPC, Baku-Tbilisi-Ceyhan and a pipeline to China. As soon as Kashagan reaches its project capacity, Kazakhstan would be able to export 25-30 million tons of oil a year via the new trans-Caucasian pipeline to Romania.

Expert Online

Russia–Ukraine

Ukraine may lease its gas transportation system

March 19, 2010

According to the first Deputy Prime Minister of Ukraine, Andrei Klyuev, Ukrainian government intends to grant its gas transportation system in concession. Gas transportation consortium should unite Russia with its gas reserves, Ukraine as a transit state and the European Union as a consumer of gas. According to Klyuev, a law on granting the country's gas transportation system in concession is almost ready.

Finam.ru

Russia, Ukraine "reload" gas relations

April 21, 2010

During the working visit of Russia's President, Dmitry Medvedev, to Kharkov, Gazprom and Ukraine's Naftogaz signed addenda to the natural gas supply contract dated January 19, 2009. The annual contract volume of gas for Ukraine was increased to 36.5 billion m^3 in 2010. Naftogaz will pay for gas with a discount equal to a reduction of the export duty on gas deliveries to Ukraine, which is set by the Russian Government. The discount is expected to make up 30% of the total gas price, but no more than $100 per 1,000 m^3, and will apply to 30 billion m^3 in 2010 and 40 billion m^3 in subsequent years. Moreover, the sides discussed measures for securing sustainability of gas deliveries from Russia to Ukraine and Europe.

The price formula, as well as take-or-pay conditions, remain unchanged. The addenda also cancelled the contract provisions covering the mutual penalty sanctions, which in practice haven't been applied.

The accord was also reached that 80% of the gas transit cost would be paid by Gazprom before the 6th day of the following month and 20% – as per the existing gas transit contract – before the 20th day of the following month.

RBK Daily, Ъ-Online

Zero–duty applied to gas deliveries to Ukraine

May 6, 2010

On April 21 Gazprom and Naftogaz inked additions to a gas-supply contract stipulating that Ukraine would get a discount price on gas equal to the size of the reduction of the export duty on gas supplies to Ukraine.

A Russian government resolution on export duty rates for gas deliveries to Ukraine, ratified by parliaments of both countries on April 27, put a zero export duty on Russian gas deliveries to its neighbour until 2019.

With a contract gas price of less than $333.33 per 1,000 m^3, the duty will be zero. If the price is equal to or greater than $333.33, the duty will be the difference between 30% of contract price and $100.

A special customs duty is in effect for 30 billion m^3 of gas sent to Ukraine this year and 40 billion m^3 that should be going to the country in 2011-2019. The volume of gas exceeding that amount will be subject to a general 30% duty on Russian gas exports. As a result, the Russian government will receive less tax – about $3 billion less in 2010 and around $4 billion in 2011.

The duty has been applicable since April 1, 2010. On May 5, Ukraine reported on fulfilling the gas payment of $419 million inclusive of the discount. According to the Ukrainian Prime Minister, zero duties saved Ukraine around $250 million. However, Kyiv still insists on changing the price formula stipulated by the gas contract of Russia and Ukraine.

Kommersant

Prospects for Gazprom and Naftogaz merger

May 14, 2010

The day before the visit of Russian President to Kyiv, Fuel and Energy Minister of Ukraine Yuri Boiko held first negotiations in Moscow on the merger of Gazprom and Naftogaz. The results of the talks are still uncertain, though Ukrainian authorities emphasise they would not agree to Naftogaz' take-over by Gazprom. Ukraine would like to preserve control over a new company, bringing in Ukrainian transportation system with Russia contributing part of its gas fields.

The idea of a Gazprom and Naftogaz merger was first made public by the Prime Minister of Russia Vladimir Putin on April 30, 2010. However, Naftogaz assets equate to approximately 8-10% of Gazprom's shares. From the very beginning, Ukraine demonstrated a restrained reaction to Russia's proposal, pointing out that the deal should be an equal merger. The take-over of Naftogaz by Gazprom is uneconomic to Ukrainian authorities. Kyiv would prefer Gazprom to buy a share in Naftogaz, which would allow Ukraine to keep

Note: Gazprom OJSC is the largest Russia's oil and gas company, which accounts for around 18% of worldwide gas production (around 461.4 billion m^3 *in 2009). The state holds 50.002% of the company's shares. Gazprom's revenues in 2009 amounted to $102 billion with the profit of $27 billion. Gazprom holds a monopoly right for gas exports and manages a unified gas transmission system with 156,900 km of gas pipelines, 268 booster stations and 24 underground storages.*

National Joint Stock Company Naftogaz of Ukraine is engaged in production, transportation and sales of energy resources. The company is wholly owned by the state. Naftogaz revenues in 2009 amounted to $10.95 billion with net profit of $290 million. The company operates Ukraine's gas transportation system with the overall length of 39,800 km. Naftogaz owns 233 oil and gas fields, 74 booster stations and 13 underground storage locations.

control over the asset and rely on investment from Russia. Alternatively, Ukraine proposes to get back to the issue of rehabilitating its gas transportation system (GTS). The country suggests three variants of investments in the project: loans from Russian and western banks with long-term maturity and a reasonable interest rate, loans from Gazprom and western energy companies on the same conditions, and establishment of a consortium for managing the GTS with investments from the consortium participants in the company's authorised capital. According to Viktor Yanukovich, the overall cost of GTS modernisation may amount to $600-700 million. He noted that Ukraine is willing to invite either Russia or the EU member states to take part in the project.

However, Gazprom's head Alexei Miller put forward Russia's key argument in the talks with Ukraine, that the Ukrainian GTS was constructed specially for transporting Russian gas to Europe and Russia can do without the GTS immediately after the construction of the South Stream gas pipeline to Europe, which is due to be completed in 2015.

Kommersant, Ъ-Online, RBK Daily

Russia–Kazakhstan

Kazakhstan awaits Russian oil

February 5, 2010

Kazakhstan is relying on the resumption of oil deliveries from Russia, halted due to unsolved issues on defining export duties after the two states introduced a single customs tariff.

Russia, Belarus and Kazakhstan formed the Customs Union and starting January 1, 2010 introduced a single customs tariff. However, the disagreements on export duties for Russian oil have already become an occasion for dispute between Moscow and Minsk, settled in late January.

On February 4, the majority of Russian oil companies suspended oil deliveries to Kazakhstan's refineries due to the possible introduction of export duties. According to Kazakhstan's Energy Minister, the disruption in oil supplies occurred due to different interpretation of the normative documents. He expressed hope that Russian customs services will clarify all points at issue and zero duty oil deliveries will be resumed.

In 2009, Russia delivered 5.7 million tons of oil to Kazakhstan for refining. The official amount of Russian oil re-exported from Kazakhstan to China amounted to around 1.5 million tons.

Reuters

Note: In its dispute with Minsk, Russia was in favour of levying a 100% export duty on oil that is being re-exported by Belarus after refining and agreed upon a zero duty on oil for Belarusian domestic consumption. Minsk accepted the bulk of Russia's conditions.

Russia, Kazakhstan agree to develop Imashevskoye field

September 7, 2010

Russia and Kazakhstan have signed agreements on joint geological exploration of the Imashevskoye gas condensate deposit and joint use of trans-border water area. The documents were signed within the framework of the seventh Kazakh-Russian forum for interregional cooperation.

The agreement on joint geological exploration of the Imashevskoye gas condensate deposit allows for the identification of the field's reserves and getting it ready for development. Given the high sulfur content (15%-17%), the field's development demands implementation of innovative technologies to raise the level of environmental safety during exploration, production, preparation and transportation of outputs.

Note: The Imashevskoe deposit, with reserves estimated at over 128 billion m^3 of gas and 20 million tons of gas condensate, is located on the border between Russia and Kazakhstan, east north-east of Astrakhan in Russia and southwest of Atyrau in Kazakhstan.

Russia and Kazakhstan are jointly developing the Khvalynskoye, Kurmangazy and Tsentralnoye oil fields. The launch of commercial crude production at the Kurmangazy field may commence by 2016.

The agreement on the joint use and protection of trans-border water area promotes the strengthening of regulatory and legal frameworks of Russia and Kazakhstan on interaction in securing rational water resources management.

The Imashevskoye field would become a first cross-border site to be developed jointly by Russia and Kazakhstan. The field has long been a matter of dispute between Russia and Kazakhstan over the border delimitation.

In March 2010, the government of Russia accepted a draft agreement with Kazakhstan on joint geological exploration of the Imashevskoye gas condensate deposit. It took the states five years to settle all issues surrounding the project.

Kursiv, Finam.ru

Russia – Turkmenistan

Ashkhabad to construct East–West pipeline

May 24, 2010

As events show, the relations between Russia and Turkmenistan haven't been restored after last year's discontinuation of Turkmen gas purchases.

The energy-rich Central Asian republic decided to build the East-West pipeline with an annual capacity of 30 billion m^3 of natural gas on its own. The construction will be funded by the state concern Turkmengaz. A resolution authorising the start of construction was signed by the President, Gurbanguly Berdimuhamedov. The works are scheduled to begin in June 2010, and the gas pipeline should be commissioned in June 2015. The construction costs are estimated at around $1 billion.

The new pipeline will allow Turkmenistan to choose whether to supply oil to Russia or bypass it completely.

The pipeline is to link Turkmenistan's north-eastern gas fields with the Caspian region and with major transnational gas transit systems beyond. Construction was to be carried out by Gazprom. The parties intended to sign a corresponding agreement in March 2009. However in April 2009, Gazprom made a move to cut exports of Turkmen gas. Some time later, a blast occurred on a natural gas pipeline and gas exports were halted completely. In May, Ashkhabad announced an international tender for construction of the East-West pipeline.

Note: In late 2009, Gazprom announced having reached an agreement with Turkmengas on resumption of gas deliveries to Russia starting January 2010 and joint implementation of a project to construct the Pre-Caspian pipeline and the East-West pipeline. However in late April Gazprom said it will purchase only 10 billion m3 of gas from Turkmenistan, or five times less than previous purchases.

RBK Daily

Russia and Turkmenistan freeze Pre–Caspian pipeline project

October 25, 2010

Russia's President Dmitry Medvedev wrapped up his visit to Turkmenistan. Igor Sechin, Russia's vice premier, who was part of the delegation, said it was decided to freeze the long-stalled Pre-Caspian pipeline following the drop in European demand. They believe consumption will rise slowly again in the next 3-4 years, but only by small amounts.

The Pre-Caspian pipeline project foresaw the transportation of 30 billion m^3 of gas from Turkmenistan to Russia through the territory of Kazakhstan and was agreed upon in 2007.

The parties touched upon the issue of Gazprom's meagre orders for gas, which this year are down to 10-11 billion m^3 of gas. Gazprom would not be increasing its orders because of reduced demand from the European Union.

Russia's President Dmitry Medvedev also discussed the possibility of Gazprom, Russia's state-owned gas monopoly, becoming involved in the Turkmenistan-Afghanistan-Pakistan-India pipeline. Gazprom is prepared to take part in any capacity – "as a contractor, as a designing company, or as a full-fledged participant of the consortium."

Kommersant

Russia – Belarus

The chronology of the Russian–Belarusian gas dispute

June 25, 2010

In accordance with a four-year agreement between Gazprom and Beltransgaz, Belarus has to pay 100% of an averaged European price for gas minus export duty and transportation expenses. In 2010, the price is subject to a reduction factor of 0.9, while Belarus insisted on a 0.7 figure. The contracted price for gas was set at $169.22 per 1,000 m^3 in the first quarter of 2010, $184.8 per 1,000 m^3 in the second quarter and an annual average of $187 per 1,000 m^3. However Belarus used a 2008 price of $150 per 1,000 m^3 to pay for gas, which led to Belarusian indebtedness.

June 11 – Belarusian President held meetings with Russian President and Premier. The parties didn't manage to settle the key issues. The situation was aggravated further by Gazprom's statement that the price for gas in 2011 will rise to $250 per 1,000 m^3.

June 15 – Russian President gave Belarus five days to settle gas payments.

June 18 – Alexander Lukashenko stated that Belarus doesn't acknowledge its debt to Gazprom.

June 21 – Gazprom commenced a gradual reduction of gas supplies to Belarus for domestic consumption against the background of painstaking negotiations on gas prices between the countries. Gazprom said that Belarus ran into debt for earlier deliveries, while Minsk, still hoping for a decrease in contracted price, demanded that Gazprom repay its debt for gas transit.

June 22 – Belarus' President ordered a halt to Russian gas transit to Europe. Gazprom considers an alternative route for gas transit to Europe, including an increase in transit through Ukraine, use of gas from European underground storage locations and the spot market.

June 23 – Gazprom limits gas supplies by 60%.

June 23 – Beltransgaz paid $260.1 million for May deliveries of Russian gas.

June 24 – Belarus confirmed that Gazprom paid off its debt for gas transit.

June 25 – Russian-Belarusian gas conflict settled, the sides reached agreement on gas transit rate for the next year.

Reuters, RIA Novosti, RBK

Gazprom, Beltransgaz sign addendum to gas supply and transit contract for 2007–2011

July 2, 2010

Gazprom and Beltransgaz signed the Addendum to the gas supply and transit contract for 2007–2011.

Due to the fact that the Belarusian party raised the 2010 wholesale mark-up for the gas sold by Beltransgaz to $11.09, as was agreed when Gazprom was purchasing a stake in the company, the rate for Russian gas transit via Beltransgaz owned networks will be equal to $1.88 per 100 km in 2010.

In addition, Gazprom and the Government of the Republic of Belarus have signed the Protocol on contributions by Beltransgaz, the joint Russian-Belarusian gas transmission company, to the Innovation Fund of the Belarusian Energy Ministry.

Pursuant to the Protocol, the Belarusian party shall set the amount of contributions by Beltransgaz to Belarusian innovation funds in 2011–2012 at the level not exceeding the minimum contribution amount adopted in the country.

The Belarusian party guarantees not to impose individual taxes, charges and contributions on Beltransgaz. It is planned to use the funds released from the reduction as contributions to the innovation fund for the construction of underground gas storage facilities in Belarus.

The decisions were made in furtherance of the accords stipulated by the protocol of December 31, 2006, on setting up the joint Russian-Belarusian gas transmission company, Beltransgaz.

Finam.ru

Oil hinders the establishment of CES

November 4, 2010

Belarus suggests unifying export customs duties and then distributing them according to the formula, similar to how the import duties on goods from non-CES countries are divided. The formula will be defined by a special agreement. However, Kazakhstan and Russia object to such unification and are studying other mechanisms, including the levying of the export customs duty on Russian oil being exported to non-CES countries through the territory of Kazakhstan in accordance with Russia's rates established on external borders. The levied funds would be transferred to Russia in full. A similar scheme would be applicable to Kazakhstan's oil delivered to non-CES countries through Russia and Belarus. At the same time, Russia and Belarus managed to agree on the order of levying export customs duty on oil and oil products. Thus, Russia suggested zeroing duty on oil being supplied to Belarus in exchange for levying export customs duty on oil products, made from this oil. However, Russian oil products supplied to Belarus will not be subject to duties on condition of unifying Russian and Belarusian export duties. The parties also agreed that export customs duty on oil products manufactured out of Belarusian oil would be transferred to Belarus' budget.

However, Kazakhstan did not support the Belarusian stance due to the export customs duty rate that amounts to $20 per ton in Kazakhstan (from August 2010), while Russian export customs duty rate will be $290.6 per ton from November.

According to specialists, the unification of Russian and Kazakh export customs duties is technically near impossible due to a different structure of tax liabilities of both countries. Levelling Kazakhstan's export duty with the Russian one would turn it into a prohibitive tariff for Kazakh oil exporters. And vice versa, if Russian export duty is lowered 14.5 times to match Kazakhstan's rates the Russian budget would loose a substantial amount of funds.

Kursiv

Moscow and Minsk agree on oil and oil products duties

December 10, 2010

During the meeting of the EurAsEC Interstate Council on December 9, 2010, the presidents of Russia, Belarus and Kazakhstan agreed to ratify all agreements on the Common Economic Space before the beginning of next year. The CES will be put into effect in 2012.

The agreement was reached after the President of Russia, Dmitry Medvedev, and his Belarusian counterpart, Alexander Lukashenko, agreed terms on oil and oil products duties.

Russia said it would drop duties on crude oil exports to Belarus from next year if Minsk hands Moscow all the duties it gets from exporting products made from Russian oil.

The negotiations lasted the whole year. Moscow didn't want to allocate investment support to Belarusian refineries that will in future receive all oil from Russia at zero duty (at present only 6.3 billion tons out of 21.5 billion are duty free).

Total abolition of duty may cost the Russian budget around $2 billion a year, however, the losses may be reduced. According to a draft agreement on export duties on oil and oil products, Belarus will have to level its rates with the Russian ones (according to Belstat, Belarus exported 15.5 million tons of oil products in 2009). In October 2010, deputy Finance Minister of Russia Sergei Shatalov noted that the duty on oil products may reach up to 90% of crude oil export duty. However, the authorities didn't dare introduce such a drastic measure at this time. The Finance and Energy Ministries have agreed the rate scale for 2011-2012. The levy for heavy oil products is set at 46.7% of crude export tax in 2011 and 52.9% in 2012. The light oil products duty is set at 67% of the crude oil export tax, starting February 1, 2011, and then 64% in 2012. Duties for the two types of oil products will then equalise at 60% of the crude tariff in 2013.

Vedomosti

Energy

Sangtuda–1 HPP produces first 3 billion kWh of electricity

February 1, 2010

Tajikistan's Sangtuda-1 HPP is one of largest energy projects in the CIS. The hydropower plant will reach its full project capacity of 670 mW with the commencement of the last, fourth power unit in 2010.

The other three power units have already been put into operation, however one of the units is currently undergoing routine maintenance and the other one was put in reserve.

Nonetheless, the power plant has already produced its first 3 billion kWh.

South Kazakhstan and Afghanistan are to become potential consumers of Sangtuda-1 HPP electricity as soon as the transmission line reaches them. The price for exported electricity is still uncertain.

Mirtv.ru

Export–import of electricity may be expanded

March 11, 2010

Inter RAO UES and Kazakhstan Electricity Grid Operating Company (KEGOC) have reached the final stage of talks on the electric power purchase and sale agreements which will be supplemented to a new agreement on parallel operation of the power systems of Russia and Kazakhstan.

Inter RAO UES expects the amount of trade transactions between Russia and Kazakhstan to triple after the parties sign corresponding agreements. Last year, Russia imported 2.1 billion kWh from Kazakhstan and exported 0.6 billion kW-hours.

During the talks between KEGOC JCS, Inter RAO UES OJSC, FGC OJSC and SO UES OJSC, the companies discussed conditions of agreements on the parallel operation of power systems of two countries, on purchase and sale of electricity, as well as electricity transmission services.

The energy companies agreed to introduce a daily approval of supplies to compensate hourly deviations during electricity transmission and specified the ceiling value for permissible deviations during daily energy interchange for a period to 2013.

The Energy Ministry of Russia and Inter RAO UES are also agreeing terms of a new agreement on parallel operation with the Nonprofit Partnership "Council for Organising Efficient System of Trading at Wholesale and Retail Electricity and Capacity Market" (NP "Market Council").

The agreements aim at boosting the long-term and mutually beneficial energy cooperation between Russia and Kazakhstan, improving the reliability and further development of the Russian and Kazakh power grids, as well as their transition to a brand new level of functioning with their increased role as system operators.

Along with reliability improvement of the two poser grids and establishment of a new market of interstate system services and reserve capacities the agreements will also boost the efficiency of Inter RAO UES and KEGOC trade operations.

Finam.ru

Russia and Kazakhstan agree to build third power unit at Ekibastuz GRES–2

July 6, 2010

During the meeting of the EurAsEC Interstate Council in Astana, Vnesheconombank, the Eurasian Development Bank, Inter RAO UES OJSC, Samruk-Energo JSC and Ekibastuz GRES-2 Station JSC signed a credit agreement to finance the project to construct a third power generating unit of the Ekibastuz Power Station with an installed capacity of up to 540 mW in Kazakhstan. The total value of the project is around $800 million.

Under the agreement Vnesheconombank's participation in financing the project is to extend a long-term (for a period of 15 years) credit line worth 12 billion roubles. These funds are to cover the costs of services and items produced by Russian companies (Silovye Machiny OJS, MZ ZIO-Podolsk OJSC, etc). The Eurasian Development Bank on a parity basis with Vnesheconombank is also to extend a 15-year credit for a total amount of $385 million. The project is in line with the EDB's mission and increases mutual trade and mutual investment. The power station is owned on a parity basis by Russian and Kazakh shareholders (OJSC Inter RAO UES and JSC Samruk-Kazyna), and a significant part of electric power generated by the power station is exported to the unified energy system of the Russian Federation.

The project to build the third power-generating unit of the Ekibastuz GRES-2 is being implemented under the agreement dated September 11, 2009 between Russia and Kazakhstan. The annual output of the Ekibastuz GRES-2 after the project's completion is scheduled to increase by 50% and amount to 10 billion kWh. This will make it possible to significantly reduce power shortages and increase electric power imports from Kazakhstan to Russia. The parties believe that the launch of the third power unit at the Ekibastuz Power Station would help to restore the unity of Russia's and Kazakhstan's energy systems, promote the development of integration trends in the former Soviet republics and enhance cooperation within the Shanghai Cooperation Organisation.

The Ekibastuz GRES-2 generates about 12% of all electric power produced in the Republic of Kazakhstan; the installed capacity of the station's two power units amounts to 1,000 mW.

Finam.ru

Russia, Belarus and Ukraine sign new agreement on parallel operation of power grids

July 14, 2010

Belarus, Russia and Ukraine signed a technical agreement on the provision of parallel operation of power systems of the three countries. The agreement was signed by FGC UES, SO UES, Belenergo, ODU republican unitary enterprise, and Ukrenergo.

This agreement is the basic document, governing the interaction of system operators and power companies, while ensuring parallel work of power systems in Russia, Ukraine and Belarus. The agreement defines responsibility and interaction between the parties, including the harmonisation of actions to plan and ensure the implementation of agreed hour schedules of power interchange balance, control of power, while maintaining the frequency and operation of interstate power lines.

Under the signed agreement, SO UES in cooperation with ODU and Ukrenergo perform a twenty-four-hour dispatching management of the parallel operation of power systems. The main responsibilities of the company include the maintenance of AC frequency within acceptable values, regulation of power interchange and power of national energy systems, coordinated planning of the parallel operation of power systems, as well as the coordination of actions to prevent and eliminate process failures.

Furthermore, the agreement foresees creating conditions for mutual exchange of technological information, necessary for the arrangement and implementation of the parallel operation of power systems of Russia, Belarus and Ukraine, as well as obligatory mutual information sharing on planned activity for technical upgrading and reconstruction of energy facilities, which affect the parallel operation of power systems.

Finam.ru

Nuclear energy

TVEL and Ukrainian Energoatom sign long–term contract

June 1, 2010

TVEL Fuel Company of Russia and the National Nuclear Energy Generating Company of Ukraine, Energoatom, signed a long-term agreement on deliveries of fresh fuel for Ukrainian NPPs after 2010.

IA REGNUM Novosti

Note: Cooperation between TVEL and Energoatom started in 1996, when the Russian company won an international tender for supplies of nuclear fuel for VVER reactors of Ukrainian NPPs. In 1997 TVEL and Energoatom signed a contract for fuel deliveries for a period to and including 2010.

Russia to finance Khmelnitsky NPP construction

June 9, 2010

Russia and Ukraine have signed an intergovernmental agreement to finish the construction of Reactor Units 3 and 4 at Ukraine's Khmelnitsky Nuclear Power Plant. The agreement was signed on June 9, in the Ukrainian capital, Kyiv, by Ukraine's Minister of Fuel and Energy Yury Boiko and Russia's head of the state nuclear corporation Rosatom, Sergey Kiriyenko.

According to Kiriyenko, this is a long-term contract to be financed via loans from Russian banks. Both Russia and Ukraine will be providing funding for the project. Russia has taken on the obligation to invest $5-6 billion. These funds are to cover the costs of services and items produced in Russia. But it is

Note: On June 7, the President of Ukraine took part in the summit of the Conference on Interaction and Confidence-building Measures in Asia (CICMA) in Istanbul and held an array of bilateral meetings. During the meeting with Russian Premier the sides touched upon energy issues. Viktor Yanukovich appealed to Vladimir Putin to render financial support to Ukraine in completing the construction of reactor units at Rivne and Khmelnitsky NPPs.

unclear for how long and on which terms exactly the export credit will be extended to Ukraine.

Ъ-Online

Challenges of Russian–Kazakh cooperation in nuclear energy

June 17, 2010

Note: From 2008, the parties have not been able to agree on the distribution of shares in the unified company, thus the draft intergovernmental agreement on creating a unified company is yet to be approved. In this regard, Russia suggested treating joint uranium production enterprises as the first stage of creating a unified company, and a joint trading company as the second stage. Rosatom has already sent its proposals and a draft agreement to the corresponding Kazakh agencies for consideration. Meanwhile, Kazakhstan announced a forthcoming uranium development programme under which Kazatomprom is scheduled to complete its transformation into a vertically integrated company with a full nuclear fuel cycle by 2020.

There is also a contradiction between Russia and Kazakhstan concerning the construction of a NPP in Kazakhstan.

Rosatom's head Sergey Kirienko arrived in Astana to discuss the state and prospects of bilateral cooperation of the two countries in peaceful uses of nuclear energy. The agenda of his meeting with Kazakhstan's Prime Minister Karim Masimov included such issues as securing gradual implementation of the project for establishing a unified Russian-Kazakh civil nuclear power company; combining efforts in the marketing of natural uranium by creating a joint trading company; and boosting work on designing a nuclear power plant and its subsequent construction. Russia is also ready to discuss the cooperation in producing fuel pellets at the Ulba Metallurgical Plant.

Both sides have to settle a considerable amount of claims and discrepancies on these issues.

On July 5, 2010, Rosatom's General Director Sergey Kiriyenko and Kazatomprom's President Vladimir Shkolnik signed two documents: A Memorandum on integration and cooperation in the field of peaceful uses of nuclear energy and a Joint statement on the uranium enrichment centre project. The first document outlines a concept for gradual establishment of a Russian-Kazakh nuclear company. "The parties confirm that they shall adhere to the principles of integration and, whilst taking consecutive steps towards a unified, parity-based nuclear company, shall strive to position it on the global nuclear fuel cycle market as a strong joint player, and make use of market conditions in the best interests of future integration", reads the memorandum. At an initial stage, this company will sell natural and low enriched uranium, as well as other products and services produced by the joint ventures to end users. The second document seals the parties' agreements in respect of common use of a uranium enrichment centre in Russia through the Kazakh shareholding in the Ural Electrochemical Integrated Plant JSC. In addition, the document outlines the principles of concerted sales and marketing policy.

Finam.ru, RBK Daily, RIA Novosti, Kursiv

Minsk puts forward new proposals for energy cooperation with Russia

July 29, 2010

Moscow refused to sign an agreement with Minsk on the construction of a first Belarusian nuclear power plant unless a joint venture for selling electric energy from the NPP is established.

Moscow lays claim to 50% of profit from energy sold from the Belarusian NPP if it is to be financed by the Russian loan.

Belarus declared that the establishment of a joint venture for sale of future NPP electric power is not under consideration; however, Belarus is willing to offer Russia its own variants. The set of agreements between Russia and Belarus on the NPP construction will be signed by the end of September at the latest. Earlier, the Belarusian leadership stated that a package of agreements on the NPP construction would be signed before the end of July 2010.

Note: Belarus plans to build the NPP with two reactor units of 1,200 mW each in its western Grodno region, with the first reactor expected to be put into service in 2016 and the second in 2018. Atomstroyexport is to implement the project. In May 2009, Belarus asked Russia for a $9 billion loan for the construction of a nuclear power plant.

On August 27, 2010, Belarus submitted its proposals to Russia. Minsk agreed on the establishment of a joint venture for sale of future Grodno NPP electric power. However, Belarus believes that the bulk of revenue should stay in the country, following the "country of origin of electricity" principle for revenue distribution. Russia refrained from commenting on the new Belarusian proposals.

Ъ-Online, Lenta.ru

Russia to help Armenia with NPP construction

August 20, 2010

According to Rosatom's head Sergei Kiriyenko, Russia may finance over 20% of the project for constructing a nuclear power plant in Armenia.

The total cost of the project is still uncertain and will depend on the NPP's equipment. The preliminary cost of construction is estimated at $5 billion. According to Kiriyenko, a recently established joint Russian-Armenian company will finance at least 40% of the NPP's cost. Investors will finance the remaining 60%. The construction of a new 1,000 mW reactor unit at the Armenian NPP will commence in 2011.

Lenta.ru

Note: Rosatom State Corporation was established in December 2007 on the basis of the dissolved Federal Atomic Energy Agency. Rosatom is actively taking part in international projects, carrying out construction in India, Iran and China. The company has repeatedly stated its willingness to undertake NPP construction projects in countries such as Bulgaria and Belarus.

Ukraine acquires 10% of Russian–Kazakh centre in Angarsk

October 8, 2010

Note: In August 2010, Nuclear Fuel signed an agreement with Rosatom on purchasing 10% of shares of the International Centre for Uranium Enrichment established in 2007 on the grounds of the Angarsk Electrolysis Chemical Complex. Kazakhstan owns a 10% stake while Russia holds 80% of the Centre's shares.

On September 5, the Ukrainian state company Nuclear Fuel became a shareholder in the International Uranium Enrichment Centre based on the Angarsk Electrolysis Chemical Complex by purchasing a 10% stake. The Nuclear Fuel state company intends to negotiate a mechanism for cooperation with the International Uranium Enrichment Centre in the very near future and collect all documents necessary for the enrichment contract.

Kursiv

Mining Industry

Polymetal to optimise Varvarinskoye

March 18, 2010

Polymetal had to engage in a large-scale optimisation of the Varvarinskoye gold and copper mine in Kazakhstan after purchasing it in 2009. The company managed to substantially curtail expenses by terminating contracts with several foreign experts, an array of contractors and an insurance agent.

Last year, Polymetal acquired 100% of the shares in Three K Exploration and Mining Limited, a wholly-owned subsidiary of Orsu Metals, which operates Varvarinskoye, for $235 million. The new owner of the mine had to make an array of fundamental changes of Varvarinskoye management. The alteration of the production process control allowed Polymetal to save $10 million. In particular, the company transferred the procedures for drafting local mining projects and reservoir modelling of the field from London to Russia. Moreover, Polymetal replaced around 15 foreign specialists (including the financial director, geologists, mechanics and mining engineers) with locals. Personnel replacements made it possible to achieve a better value for money ratio and save $1.5 million a year.

Polymetal also reviewed the mine's expenses for insurance by terminating the contract with the current insurance agent and holding a large-scale tender. As a result, the company will save $1.3 million in 2010. In addition, Polymetal revised agreements with a contractor and a buyer to exclude unbeneficial conditions for the seller (Varvarinskoye), which in its turn saved the company a further $3.1 million.

RBK Daily

Polyus Gold problematic asset

July 21, 2010

Kazakhstan has launched a process aimed at terminating a merger of Russia's top gold producer, Polyus Gold, and Kazakh gold miner KazakhGold Group Ltd due to the undercharging of the deal price.

In autumn 2008, Polyus Gold estimated KazakhGold's controlling stake at $746 million, but the company's capital had considerably fallen, so the companies later agreed on a merger valued at $269 million.

Note: In July, KazakhGold and Polyus Gold, which owns 50.1% of KazakhGold via its subsidiary Jenington International Inc, announced a reverse takeover, under which KazakhGold would acquire its parent company Polyus Gold. Under the scheme, one share of Polyus Gold will equal 9.26 Global Depository Receipts of KazakhGold, and one American Depository Receipt of Polyus Gold will equal 4.885 GDRs of its subsidiary. The deal is aimed at merging the two companies into one holding, which will be traded on the London Stock Exchange as a single company, while Polyus Gold plans to delist its ADRs from the LSE soon.

In late June 2010, Kazakhaltyn MMC JSC, a subsidiary of KazakhGold Group Limited belonging to Polyus Gold, and Jenington International Inc., controlled by the Russian company, initiated a trial against former leadership and core owners of KazakhGold, in relation to a violation of several contract terms and fund embezzlement of $200 million.

Established in 2006, Polyus Gold is the leading gold producer in Russia and Kazakhstan and the only Russian company among the world's largest gold producers. Polyus Gold's operating mines and development projects are located in five Russia's major gold mining regions, as well as in the Republic of Kazakhstan, Romania and Kyrgyzstan.

KazakhGold is one of the largest and oldest gold mining companies in Kazakhstan (established in 1929) with three principal operating mines, Aksu, Bestobe and Zholymbet located in the northern part of Kazakhstan with estimated reserves of around 60 million ounces of gold.

Machine Building Industry

Russia and Kazakhstan establish car assembly JV

April 12, 2010

Russian Industry and Trade Minister, Viktor Khristenko, visited Kazakhstan to settle problems in the automotive and aviation industries, which originated from the establishment of the Customs Union. Following the results of Khristenko's meetings with Kazakhstan's Prime Minsiter Karim Masimov, Economic Development and Trade Minister Zhanar Aitzhanova, Oil and Gas Minister Sauat Mynbayev and first Vice-Minister of Industry and New Technologies Albert Rau, the parties adopted several decisions. First of all, they agreed to ease customs regulations for export-import of cars from Russia's and Kazakhstan's secondary markets, which will pave way for Kazakh traders to access the much larger Russian second-hand auto market. Second, the sides agreed to establish a car assembly joint venture in the short term.

The JV will have a project capacity of 50,000 cars a year, with an estimated project cost of around $200 million. The project will be implemented under government support with Kazakhstan providing 25% of the project's total cost at the initial stage.

Note: Sollers OJSC is a Russian automobile company that provides a full scope of automobile services comprising all stages from manufacturing to sales and maintenance services. The company produces such brands of cars as UAZ and SsangYong. In late February, Sollers signed an agreement with Italian Fiat on establishing a joint venture to produce Fiat and Chrysler brands with a capacity of up to 500,000 cars a year. The project's cost totalled €2.4 billion.

Sollers OJSC will represent Russia in the parity-based car assembly plant, while Kazakhstan still needs to choose which company will be involved.

The sides didn't specify the range of car brands the joint venture will be assembling, though a possible production of Ssang Yong SUVs, in addition to Fiat-based car manufacture, was also discussed.

The joint venture will be headquartered in Karaganda Industrial Park or Stepnogorsk.

Kursiv

Russia, Ukraine to integrate aircraft industries

April 23, 2010

Russia and Ukraine once again announced their intention to unite the countries' aircraft manufacturers. A unified company will aim at widening joint production and supplies of An-148, An-124 and An-140 plane series. Additionally, the joint venture will be responsible for developing and implementing common marketing policies on local markets and abroad. The establishment of a unified company is only an intermediate stage of integrating aircraft industries of both countries.

Russia's United Aircraft Corporation (UAC) may receive a controlling stake in the Ukrainian state-owned aircraft manufacturer, Antonov, in exchange for a stake in the Corporation. According to the last draft agreement on cooperation in aircraft industry, Russia's UAC will receive a 50.01% stake in Antonov. In return, Ukraine will receive a stake in UAC, but its size will be determined after an independent evaluation of the market values of Antonov and UAC. The deadline for the final decision is August 1, 2010.

Ъ-online

Note: Rostselmash and Kazservice established a joint venture for assembling VECTOR grain harvesters on the basis of Kazakhstan's Vector Grain Harvesters Plant LLC.

Rostselmash made it into the world's top 5 companies engaged in production of grain harvesters and other agricultural equipment with over 2.6 million units of equipment sold in 48 countries. The company accounts for 17% of the world's agricultural equipment market and 65% of the Russian market. Rostselmash produces ACROS, VECTOR, DON 1500B, Niva-Effect, and DON 680M grain and fodder harvesters.

Rostselmash wins 40% of Kazakhstan's grain harvesters market

October 25, 2010

One in ten grain harvesters produced by Russia's Rostselmash is being supplied to Kazakhstan, Rostselmash press service announced.

From 2000, supplies to Kazakhstan topped 5,000 grain harvesters. Rostselmash now accounts for 40% of the Kazakh grain harvesters market.

According to the company's representative in Kazakhstan, Rostselmash is currently in the lead on Kazakhstan's market in terms of grain harvesters and tractors.

Kursiv

Transmashholding acquires Luganskteplovoz

June 15, 2010

The State Property Fund of Ukraine declared Russia's Bryansk Machine Building Plant (BMZ, part of Transmashholding) a winner in the tender for the sale of 76% in Luganskteplovoz, which offered $51.8 million for the asset. Thus BMZ became the owner of Luganskteplovoz for the second time. Luganskteplovoz was first privatised in March 2007. It was sold to BMZ for $58 million. However, the results of the competition were cancelled by court, and this stake went back to state ownership.

In 2007 Transmashholding had paid UAH 292.5 million for the 76% stake; the contract was signed in USD and equalled $58 million. At the 2009 auction, the selling price of the stake equalled UAH 410 million or $52 million. Thus, Transmashholding demanded the State Property Fund of Ukraine compensate the difference between the USD-denominated prices, while the Fund refused to do it.

Earlier Transmashholding announced its intention to invest around $120 million in Luganskteplovoz during the next 15 years. In 2009, Luhansteplovoz curtailed the production to UAH 523.5 million ($66 million) compared to UAH 1.272 billion in 2008.

September 1, 2010 – The State Property Fund of Ukraine sent a letter to Bryansk Machine Building Plant inviting it to break the contract on acquisition of a 76% stake in Luganskteplovoz by the parties' mutual consent. As the State Property Fund noted, this proposal resulted from Bryansk Machine-Building Plant's failure to pay the amount it had declared at the privatisation tender for the state-owned shares of Luganskteplovoz.

According to the Fund, within the framework of the contract the Bryansk plant had to transfer the full amount of funds for the purchase of Luganskteplovoz to the Fund's account by August 31, but this was not done. As a consequence, the buyer lost its right to return of the paid bid deposit (UAH 40 million) and would have to pay additional UAH 82 million as a fine, as well as UAH 2 million as a penalty for delay.

The Russian company has 20 days to either accept the offer of the Fund or to pay for the company with all the penalties. Otherwise, the Fund will have to go to court to terminate the contract.

December 22, 2010 – The last obstacle to closing the deal on the acquisition of Ukraine's Luhanksteplovoz by Russian Transmashholding was finally removed. The State Property Fund of Ukraine agreed to a cross-cancellation of debts with Transmashholding's subsidiary, Bryansk Machine Building Plant, making it possible to close the deal in the near future.

Reuters, RBK Daily

Financial Sector

MICEX gets permit to buy FSTS

April 2, 2010

The Antimonopoly Committee of Ukraine granted permission to Moscow Interbank Currency Exchange (MICEX) to purchase over 50% of shares in the Ukraine's First Stock Trading System (FSTS).

In late December 2009, the FSTS Association, which is the 100% owner of FSTS, approved a plan to bring in MICEX as the strategic investor. FSTS will place 1,601 new ordinary nominal shares in favour of MICEX at a nominal price of UAH 16.01 million. The issue will double the charter capital to UAH 32.01 million and give MICEX 50% plus one share.

The shares will be sold for a total of $10 million at the hryvnia exchange rate as of the settlement date. That corresponds to about UAH 50,000 per share.

The cooperation between MICEX and FSTS began in April 2009 with the launch of a new trading system of the FSTS. The trading system was developed on the basis of the IT platform ensuring the operation of the MICEX Group's on-exchange market. Further development of the project envisages the creation of a unified trading system that will combine the terminals of the stock, derivatives, currency and commodity markets.

RBK Daily

Kazakhstan's bank awaits Russian depositors

September 16, 2010

The subsidiaries of Kazakhstan's banks continue to expand their operations in Russia. The Central Bank of Russia granted a retail banking license to the Russian subsidiary of Kazakhstan's Centre Credit Bank, Bank BCC-Moscow. Bank BCC-Moscow started

Note: Currently two other subsidiaries of Kazakh banks, AMT Bank (42.8 billion roubles in assets) and Moscommertsbank (28.8 billion in assets) operate in Russia.

its operations in Russia in 2008 and offered only consumer credits and remittances. In the short-term, the bank plans to launch new products, including an auto-credit programme and mortgage, while financing of small and medium sized enterprises will remain the bank's main focus.

Bank BCC-Moscow foresees a two-fold increase of its capital resources and a five-fold increase in its credit portfolio.

RBK Daily

Sberbank's Kazakh Unit places 10 billion tenge bonds

November 18, 2010

The Kazakhstan-based subsidiary of Russia's Sberbank has completed the initial placement of registered coupon junior bonds in the informal market for a total amount of 10 billion tenge. The subsidiary is offering 5 billion tenge in seven-year first-series and 5 billion tenge in nine-year second-series bonds, issued as part of the first bond programme. The placement of the aforementioned papers was carried out through subscription.

Second tier banks, pension funds, insurance companies, broker and managing companies and individuals participated in the subscription.

The total demand for the bonds exceeded the amount of the issue by 4 times. The Bank satisfied orders with a yield of up to 7% APR.

The proceeds will be used to bolster the subsidiary's capital and step up lending to SMEs and larger enterprises, funding for investment projects and other purposes.

Kursiv

Sberbank to set up FDI Fund for Belarus

November 22, 2010

Sberbank of Russia has plans to set up a foreign direct investment fund (FDI Fund) for Belarus, Chairman of the Board of BPS-Bank Vasily Matyushevsky told reporters on November 19. Sberbank is currently in the process of selecting the eligible investment projects. The FDI Fund's resources will be provided by Sberbank and other co-investors.

Apart from that, BPS-Bank and Banque Havilland (Luxemburg) are setting up another FDI Fund in Belarus of $100 million. During the next two years, the FDI Fund will invest in Belarusian Biokom, engaged in production of milk substitute and fodder additives for farm livestock. BPS-Bank will manage the fund.

Another BPS-Bank's four-year project deals with the construction of 9 hotels and 12 restaurants in Belarus by the Netherlands' Blue Eagle Private Equity.

The project is estimated to cost $200 million. Investors will provide at least 50% of the financing.

Moreover, EBRD plans to provide BPS-Bank with a $50 million loan for further credit financing of small and medium-sized enterprises. According to Matyushevsky, the substantial part of the resources will be provided by the project proponent. However, BPS-Bank is ready to provide its own funds and raise financing from local and foreign banks.

Sberbank arranged the debut issue of Belarus' $1 billion Eurobonds and two issues of rouble-denominated bonds totalling 7 billion and 8 billion roubles on the Russian market.

Vedomosti

Unified conditions for banks and currency markets of Customs Union member states

November 24, 2010

The Economic Development Ministry of Russia published a draft agreement on the principles of a coordinated currency policy in the countries participants of the Common Economic Space. According to the agreement, Kazakhstan, Russia and Belarus will open their national currency markets for each other on conditions of a favourable legal treatment.

The sides will coordinate their exchange rate policies; secure the convertibility of national currencies on current and capital accounts of the balance of payments without restrictions, and create conditions to the central banks for investing their foreign currency assets in national currencies and government securities of the states participants to the agreement.

Kazakhstan, Russia and Belarus will also secure a free movement of cash money and securities between the states by residents and non-residents of the countries participants to the agreement. The sides will unify the requirements for control of foreign exchange transactions, as well as norms of responsibility for violating the legislative acts on currency regulation. The three countries commit to hold mutual consultations in order to prepare and coordinate exchange rate policy actions, systematically exchange information on the state and prospects for currency market development, and establish an integrated currency market of the states participants to the agreement.

Moreover, Russia's Economic Development Ministry also published a draft agreement on creating conditions for free movement of capital on financial markets of the Common Economic Space member states.

According to the agreement, the sides will harmonise their national banking legislation with regard to acquiring stakes in the banks by investors from countries participants to the agreement, as well as methods of risk regulation on financial markets.

Kazakhstan Today, Kursiv

Kazakh–Tajik Direct Investments Fund

November 24, 2010

Kazakh-Tajik Direct Investments Fund has been officially presented in Dushanbe. The fund was established by the Kazyna Capital Management and the Tajik State Committee for Investments and State Property Management. The fund's authorised capital of $80 million will be invested into a series of projects on the territory of Tajikistan, Chairman of the Kazyna Capital Management's Board Abai Alpamysov told the reporters. The overall goal of the Kazakh-Tajik fund, which is registered in Kazakhstan, is to implement investment projects on the territory of Tajikistan that are linked with Kazakhstan's economy and other projects. The fund will prioritise projects in such spheres as the financial sector, telecommunications, light industry, food industry, energy, non-ferrous metal industry, and metal mining industry. Speaking at the presentation, Akyl Akylov – the Tajik Prime Minister – said that the fund was initiated by Tajikistan's President Emomali Rakhmon and his Kazakh counterpart Nursultan Nazarbayev with the goal of attracting investment in Tajikistan's economy. The Tajik PM stressed that the Fund will give an impetus to the development of cooperation and will contribute to the further development and strengthening of economic relations between the two states.

Kursiv

Belarus places bonds in Russia

December 24, 2010

Belarus became the first foreign country to float bonds on the MICEX in the amount of 7 billion roubles and 8.7% annual interest rate. Sberbank of Russia has been authorised to organise the floatation of Belarusian bonds in Russia. The leadership of the Federal Service on Financial Markets expressed hope that other issuers, including non-CIS ones, will follow Belarusian example.

According to Sergei Vidyayev, head of primary bond issues department at Troika Dialog, the Russian market is very promising and has two major advantages – a high liquidity level and an option of placing rouble-denominated bonds with the future conversion into US dollars.

Floatation of CIS issuers' bonds on the Russian market goes in line with the plans of turning Moscow into an international financial centre with the Russian rouble becoming an interregional currency for corporations and banks in the CIS.

Vedomosti

Transport

Kazakhstan Temir Zholy and Russian Railways unite to compete with sea carriers

September 16, 2010

Kazakhstan Temir Zholy (KTZh) and Russian Railways (RZD) intend to join efforts in competing with sea carriers by simplifying the customs clearance of cargo and establishing a unified customhouse broker. A memorandum of mutual cooperation between KTZh and RZD in customs procedures on the customs territory of the Customs Union was signed during the meeting of the presidents of Russia and Kazakhstan in Ust-Kamenogorsk on September 7.

Transit freight traffic, mainly railway transportation, suffered a sharp decline after the disintegration of the Soviet Union. The neighbouring countries and part of Russia's regions gave way to overseas transportations. The revival of freight turnover became one of the reasons for the establishment of the Customs Union and a single transport territory within the framework of the EurAsEC. However, the parties first need to unify their customs legislation and settle a set of issues on international freight traffic. Both Russia and Kazakhstan supported a pilot project to establish a joint venture between the Customs Broker Centre LLC, the certified customs broker of the RZD, and Kazakhstan's Transport Services Centre JSC.

According to KTZh, the establishment of a JV could cut down time needed for customs clearance of cargo. The consigners will pay for the JV services, by-passing the customs brokers. The JV will also be responsible for issuing shipping documentation and declarations, as well as exchanging information with KTZh, RZD and customs services.

The concentration of information on international transit freight traffic under one structure would make it possible to monitor car detention and plan trans-shipment of cargo. Generally, the JV will speed up freight traffic, raise the reliability of customs processing and promote the establishment of a unified customs network, which in its turn would boost the profitability of transit freight traffic.

Kursiv

Turkmenistan suspends license of Russia's MTS subsidiary

December 22, 2010

Mobile TeleSystems OJSC (MTS), the leading telecommunications provider in Russia and the CIS, announces that the Company has suspended its operations in Turkmenistan in accordance with the notice from the Ministry of Communications of Turkmenistan received by MTS on December 15, 2010. The notice informed the Company of a decision to suspend licenses held by Barash Communications Technologies, Inc. (BCTI), MTS' wholly-owned subsidiary in Turkmenistan, for a period of one month starting from December 21, 2010.

According to the Turkmen Ministry of Communications, the BCTI's license was suspended due to the expiration of the trilateral agreement signed between BCTI, MTS and the Ministry of Communications in 2005. However, the Ministry of Communications failed to grant the extension in accordance with the terms of the Agreement.

As of September 2010, MTS Turkmenistan had 2.39 million subscribers.

BCTI boosted third quarter revenue 29.7% year-on-year to $55.9 million. OIBDA rose 32.7% to $34.1 million and the net profit was up 34.6% to about $21 million.

MTS has been operating in Turkmenistan under a trilateral agreement signed in November 2005 by BCTI, MTS and the Ministry of Communications of Turkmenistan, which expires on December 21, 2010, unless extended pursuant to its terms and conditions.

In accordance with certain provisions of this agreement, BCTI shares net profit derived from its operations in the country with the Ministry of Communications of Turkmenistan. The amount of shared net profit is calculated based on the financial statements prepared in accordance with local GAAP subject to certain adjustments. Under the terms of the agreement, BCTI shared 49% of the net profit since the date of acquisition through December 21, 2005, and 20% of the net profit commencing December 21, 2005.

Since the acquisition of BCTI in 2005 for $46.55 million, MTS invested around $280 million in Turkmenistan. The Company has brought legal actions against the Ministry of Communications of Turkmenistan in the International Court of Arbitration and in the Arbitration Court of Turkmenistan (this court dismissed MTS' suit) in connection with the decision to suspend BCTI's licenses.

Turkmentelecom has already dissolved a lease agreement with BCTI and MTS has to dismantle 90% of its equipment by the end of the year. Furthermore, from January 1, 2011 the company will be deprived of frequencies and has to cancel contracts with subscribers and settle payments with them.

RBK Daily, Vedomosti

Agriculture

Russia bans grain exports

August 5, 2010

The Russian Prime Minister Vladimir Putin signed a decree to ban grain exports between August 15 and December 31 this year due to the drought in the country.

According to Putin, Russia has a sufficient amount of reserves, however, it is necessary to prevent domestic prices in Russia rising, as well as preserve the cattle stock and form reserves for the next year. The ban applies to wheat and maslin, barley, rye, corn, and wheat and wheat-and-rye flour.

Agropromsoyuz doesn't leave out a possible extension of the ban on grain exports until mid 2011.

September 1, 2010

The Russian government has partially lifted a grain export ban, introduced from August 15 to December 31, and allowed exports under international contracts signed by the Russian Federation and as humanitarian aid. The regulation permits grain and flour exports to create grain reserves under the Custom' s Union legislation and to feed Russian military, diplomatic, consular and other missions abroad.

Grain can also be exported for rescue operations, as well as to feed Russian ships and Russian organisations on the Svalbard archipelago.

October 25, 2010

Russia, once the world's third-biggest wheat exporter, has extended a ban on overseas sales of grain until July 1, 2011 to ensure domestic supply after drought damaged crops, Prime Minister Vladimir Putin said. According to him, the stability of Russia's internal food market and the feed for livestock must be the priority.

Putin also backed the governors' proposal to extend discounts on grain transportation by rail. He said preferential railway transportation tariffs for grain will be valid till July 1, 2011.

Moreover, the reduced tariffs will also be applicable to rail transportation of soy and soy oil meal being delivered from the Far East regions.

RBK, Finam.ru, Kursiv, RBK Daily

Other sectors

EuroChem expands agrochemical network in Ukraine

March 17, 2010

EuroChem is investing over 25 million roubles to establish a new distribution centre for Agrocentre EuroChem-Ukraine in Northern Ukraine.

The new Agrocentre EuroChem-Ukraine distribution centre will provide additional interseasonal storage space for 50,000 tons of fertilisers, reduce annual logistics costs, increase efficiency, and raise mineral fertiliser sales. In addition, the distribution centre will provide employment opportunities for residents of Buryn in the Sumy Region.

The new distribution centre will open in October 2010, on premises covering 9.3 ha and including a 6,500 m² warehouse, an administrative building, power substation, water tower and other facilities. The new distribution centre will be strategically located near the Bakhmach railway station through which EuroChem delivers mineral fertilisers to Ukraine from PG Phosphorite (Leningrad Region) and NAK Azot (Tula Region).

Note: Agrocentre EuroChem-Ukraine is part of EuroChem Agro-Network and operates two leased sites in Ukraine – Krasnogorovka (Donetsk Region) and Kazatin (Vinnitskiy Region). EuroChem Agro-Network is a network of agricultural centres located in the key grain producing regions of Russia. EuroChem's agricultural centres provide a full range of agricultural products and services: mineral fertilisers, plant protection agents from leading international providers, high quality seeds from Russia and abroad, mixed fertilisers, soil analyses and field surveys, precision technology applications of agrochemical products on fields, storage, delivery, agrochemical product packaging, water-soluble fertilisers and microelements, as well as agrochemical consulting services.

Wimm–Bill–Dann loses business in Uzbekistan

September 20, 2010

One of the largest Russian dairy and food producers, Wimm-Bill-Dann Foods, lost its business in Uzbekistan. The property of Wimm-Bill-Dann's local subsidiary, WBD-Tashkent, was nationalised by decision of the Tashkent Municipal Court. Authorities claim company management breached Uzbek tax and customs law, produced defective products, embezzled property and did not invest the previously pledged amount of $7.2 million in capacity upgrade (WBD had previously invested some $5 million in the Uzbek business and planned to invest up to $2.2 million more by the end of 2011). Earlier in 2010, a criminal case was initiated against management of WBD Tashkent; however, it was closed a few days ago, while the company's assets were acknowledged instruments of crime and nationalised.

Note: WBD launched its business in Uzbekistan in 2004 after buying 77% of a local company Toshkentsut for $131,400. The company planned to invest $7.2 million in the project by late 2011. In 2005, the Uzbekistan authorities offered it tax privileges, which were to last until 2011. In September 2005 WBD-Tashkent launched production of milk, with the capacity of around 60 tons a day.

Finam.ru, RBK Daily

Russia's Pharmstandard buys Ukraine's Biolek

November 19, 2010

Note: Pharmstandard is the leader of the Russian pharmaceutical industry. Pharmstandard became a public company in 2007 by offering the public 27.6% of its share capital in the form of GDR on the London Stock Exchange (LSE) and 18.1% of its share capital in the form of ordinary shares on two local stock exchanges (RTS, MICEX). Approximately 54.3% of the company's voting shares are held by Augment Investments Limited.

The Ukrainian Antimonopoly Committee granted permission to Russia's Pharmstandard to purchase over 50% of shares in Ukrainian pharmaceutical company Biolek. Biolek, the largest Ukrainian pharmaceutical company, produces immunobiologicals, vaccines, serums and diagnostics products, as well as culture mediums and hormonal, antiviral, antibacterial, enzymatic and blood products.

In 2009, the company accounted for 0.18% of Ukrainian pharmaceuticals market. According to unaudited data, Biolek's sales comprised $12 million in 2009.

Pharmstandard's acquisition of Ukrainian pharmaceutical company Biolek will increase the Russian drug-manfacturer's already extensive portfolio and substantially boost its presence in the Ukrainian drug market.

Vedomosti

Rosatom buys Ukrainian special steel maker

December 27, 2010

Rosatom found an alternative source of metallurgical production. The Russian nuclear power engineering company Atomenergomash, which is incorporated in the Rosatom state corporation, has bought a controlling stake of Energomashspetsstal, a producer of special steel in Ukraine. The deal on acquisition of a 92.68% stake in Energomashspetsstal from the Cyprus-based EMSS Holdings Limited was closed on December 21, 2010. The total sum of the deal was not disclosed.

The acquisition of a Ukrainian asset is a pivotal decision for Rosatom, for it demonopolises the steel market, turning Energomashspetsstal into another supplier and thus ruining the monopoly of OMZ Special Steels LLC.

The significant share in Energomashspetsstal backlog of orders falls to the contracts with Russian enterprises, such as ZIO Podolsk, Power Machines, Ural Turbine Plant, AEM-technologies and others. After joining Atomenergomash Company Group, Energomashspetsstal will obtain the opportunity to expand greatly its cooperation with the nuclear power plants. The plant will become a supplier for Alstom-Atomenergomash Joint Venture too, where low speed turbines for NPPs will be manufactured.

After the implementation of the project aimed at completion of power unit No. 3 and 4 at Khmelnitsky NPP, Energomashspetsstal will become the main supplier of semi-finished metallurgical products for manufacturing of equipment of reactor and turbine houses.

RBK Daily

SECURITY

Agreement on Manas to be prolonged

March 10, 2010

Kyrgyzstan's President Kurmanbek Bakiyev held a meeting with commander of US Central Command General David Petraeus. During the meeting, Bakiyev noted that Kyrgyzstan is interested in restoring stability in Afghanistan and sees no reasons to terminate agreement, according to which the US military use Manas International Airport as a centre for transit traffic to transport servicemen and equipment to Afghanistan. The agreement expires on June 22, 2010; however, if neither of the parties makes an official statement terminating it, the agreement is automatically prolonged for another year.

On February 20, 2010, Bakiyev met with Richard Holbrooke, the U.S. special envoy to Afghanistan and Pakistan to discuss Manas issues.

Kommersant

Multilateral cooperation of Caspian states

March 12, 2010

On March 11-12, Baku hosted the Third Summit of the Five Caspian Littoral States, which touched upon issues of security. The leaders of the Caspian states signed an agreement on security cooperation. Azerbaijan, Russia, Kazakhstan, Turkmenistan and Iran agreed to cooperate in countering terror, organised crime, drug trafficking, proliferation of weapons of mass destruction and poaching, as well as providing security for the oil pipelines infrastructure.

However, security issues are just one component of interrelation between the Pre-Caspian states. The framework agreement on the legal status of the Caspian Sea is still missing. In other words, for almost twenty years all five states that have access to the Caspian Sea, namely Russia, Iran, Azerbaijan, Kazakhstan and Turkmenistan, have been unable to agree on how to divide the inland Sea along national lines and how to manage its vast hydrocarbon resources.

In 2003, Russia, Kazakhstan, and Azerbaijan signed an agreement to define national boundaries according to the median line principle. Iran argues against this principle for it will leave the country with 13% of the Caspian seabed. In this light, Iran proposes dividing the seabed into five equal parts of 20% each. The resolution of the Caspian issue is an important condition for Kazakhstan's successful implementation of a state programme to develop Kazakhstan's sector of the Caspian Sea in the period to 2015. Generally, Kazakhstan expects to satisfy the most of its own interests within the framework of the final decision on the Caspian. In particular, its own scheme for dividing the Caspian Sea between the five states sees Kazakhstan receiving the largest part, which amounts to approximately 30%.

Kursiv

Military and Political Cooperation

Russia's Black Sea Fleet to stay in Crimea after 2017

April 21, 2010

Note: The previous agreement on the deployment of Russia's Black Sea Fleet in Ukraine was signed on May 28, 1997 for 20 years. According to the agreement, the Fleet could be stationed in Sevastopol up to 2017 with an annual rent of $97.75 million. The addenda to the agreement on gas supplies, signed on April 21 in Kharkov, grants Ukraine a 30% discount on gas in exchange for extending the deployment of the Black Sea Fleet in Sevastopol till 2045.

On April 21, 2010, the Ukrainian President Viktor Yanukovych and his Russian counterpart Dmitry Medvedev signed a deal extending the lease allowing Russia's Black Sea Fleet to be stationed in Crimea, Ukraine for another 25 years beyond its original expiry date of 2017, with a possible further 5-year-extension.

Yanukovich noted that the sides speeded up the decision-making due to the fact that Russia "needed certainty about its navy base stationed in Crimea". He also explained that the Black Sea Fleet guarantees security to all the countries of the Black Sea.

The agreement was ratified by the parliaments of both countries on April 27. Members of the Ukrainian opposition are protesting the fleet agreement as it violates Ukraine's constitution, which prevents foreign countries from holding bases on Ukraine's territory.

Ukraine's constitutional court held that the agreement on extending deployment of the Black Sea Fleet in Crimea corresponds to Ukrainian constitution. Yanukovich also noted that the ratification of the agreement was carried out within the law and will be implemented.

Ъ-Online, RIA Novosti

Uzbekistan closes its border with Kyrgyzstan

April 7, 2010

Kyrgyzstan closed its border with Kazakhstan at the request of the Kazakh authorities. According to Kyrgyz Border Guard Service, the border was closed for an indefinite time, which would depend on the social and political situations in Kyrgyzstan.

The state border between Kyrgyzstan and Uzbekistan is also temporarily closed at Tashkent's initiative. Kyrgyz state borders with China and Tajikistan are open and functioning in a normal mode.

Acting Kyrgyzstan Defence Minister Ismail Iskakov said earlier that the border control was reinforced.

RIA Novosti

Note: Protest rallies swept over different cities of Kyrgyzstan due to the authorities' ban to hold the people's qurultai (meeting) and the arrest of opposition leaders. On April 6, riots broke out in Talas regional centre in the north, the mob seized the local administration. In the morning of April 7, public rallies were organised all over Kyrgyzstan with demands to free the opposition leaders. Protesters in Bishkek took hold of a state television broadcaster, parliament's building and battled through to the government. In the afternoon, the leaders of opposition were set free. On April 8, the newly established opposition government announced the dissolution of Parliament and the assumption of the president's and the Cabinet's authority. The acting government intended to function for six months until amendments to the Constitution were introduced. The Kyrgyzstan President, Kurmanbek Bakiyev, left the country after the mass protest rallies.

Kyrgyzstan cuts irrigation water supply to Zhambyl region, Kazakhstan opens border with Kyrgyzstan

May 18, 2010

Kyrgyzstan cut off water supply to Kazakhstan's Zhambyl region from the Kirov reservoir on May 18, without warning. Moreover, on May 19, Kyrgyzstan halted the discharge of water from the Chumysh hydro system to the Chu River. The water level in the trans-border Talas River decreased drastically. Around 173,000 ha of Zhambyl region's 520,000 ha of crop area are irrigable and in order to preserve the emerging crops water supply has to be restored in the shortest possible term.

Kazakhstan closed its border with Kyrgyzstan after Kyrgyzstan's April turmoil. The representatives of local business circles noted that by closing the border, Kazakhstan deprived Kyrgyzstan of around $1 billion in revenue for the country's economy. According to experts, over 80% of goods produced by Kyrgyzstan's light industry, as well as milk and dairy products are being exported through the territory of Kazakhstan.

May 19, 2010

On May 20, Kazakhstan will re-open its border with Kyrgyzstan, Kazakh Foreign Ministry reported. "Given the difficult social and economic situation in Kyrgyzstan and taking into account the numerous appeals of Kyrgyz citizens," the President of Kazakhstan instructed the government to lift temporary restrictions, imposed on the Kazakh-Kyrgyz border, at the Kordai, Sypatai Batyr, and Aisha Bibi checkpoints, runs the statement of the Foreign Ministry.

The checkpoints will service international transit passenger and freight traffic, as well as transportation of foodstuffs, medications, fuels and lubricants and agricultural produce across the state border.

Meanwhile, the border, customs and migration control will be reinforced in order to provide prompt counteraction of possible challenges and threats.

IA Novosti-Kazakhstan, Kursiv

CSTO will not send troops to Kyrgyzstan

June 11, 2010

Note: Inter-ethnic clashes between Kyrgyz and ethnic Uzbeks broke out in the southern Kyrgyz city of Osh on June 11. Law enforcement authorities failed to put a stop to the conflict that has rapidly spread to the neigbouring areas. The interim government imposed the state of emergency in the cities of Osh and Uzgen, as well as Kara-suu, Aravan and Uzgen regions of Kyrgyzstan and brought troops into Osh. People have fled to the neighbouring Uzbekistan trying to escape from attacks and robbery. According to the United Nations Office of High Commissioner for Human Rights (OHCHR), the number of refugees reached 275,000 people. At least 258 people were killed and hundreds suffered injuries.

The Russian President, Dmitry Medvedev, said the Collective Security Treaty Organisation post-Soviet security bloc will not intervene to stabilise the situation in volatile Kyrgyzstan.

Medvedev said the forces of the, which includes Kyrgyzstan, Russia, Armenia, Belarus, Kazakhstan, Uzbekistan and Tajikistan, can only be deployed when the border of a member state is violated.

RIA Novosti, ITAR TASS

CSTO to send aircraft, military equipment and transport, special warfare

June 14, 2010

The Collective Security Treaty Organisation (CSTO) met in Moscow to discuss how to halt rioting and clashes that have left parts of two cities in southern Kyrgyzstan in ruins and sent tens of thousands of Uzbeks fleeing for the border. Reporting to Russian President Dmitry Medvedev, CSTO Secretary General Nikolai Bordyuzha said national security chiefs from the seven-nation bloc hammered out a proposal to help Kyrgyz authorities by supplying equipment, helicopters, ground transportation, gasoline and special warfare but not weapons.

The Collective Security Treaty Organisation has at its disposal all the necessary arsenal of measures to act in similar situations – a peacekeeping contingent, and the collective rapid response forces in Central Asia. But they should be used after careful consideration, the CSTO Secretary General, Colonel General Nikolay Bordyuzha noted.

Fergana.Ru

Uzbekistan, Kyrgyzstan to settle border issues

June 1, 2010

The chairman of the State Border Service of Kyrgyzstan, Colonel Kurmankul Matenov, and the Commander of Uzbek border guard troops, Major General Ruslan Mirzayev, met in the Vuadil village of the Ferghana Valley on June 1 to discuss the situation on the Kyrgyz-Uzbek border.

The parties intended to settle the conflict that started at the border on May 26, when tensions aroused between the Kyrgyz Sogment village and Uzbek Khushyar village near the Uzbekistan's enclave of Sokh. Following the results of the meeting, the sides agreed on an array of issues. In particular, the sides agreed to

- boost the activities of the intergovernmental commission on issues of delimitation and demarcation of the state border,
- review the issue of constructing temporary reinforcing obstacles in separate sections of the Kyrgyz-Uzbek border that are exposed to conflicts,
- create necessary conditions for secure operations of all Uzbek and Kyrgyz checkpoint facilities,
- take appropriate measures to prevent conflict situations over water and land use in the concerted and unconcerted sections of Kyrgyz-Uzbek border. Regional authorities of both countries expressed intention to sign a corresponding bilateral agreement on use of pastures.

Note: On June 2, Uzbekistan began to withdraw heavy armoured units from the Sokh enclave.

In addition, Uzbekistan agreed to withdraw heavy armoured forces from the Sokh enclave that were introduced following the events in Batken in 1999-2000. According to the Batken regional administration, currently there are 45 units of heavy armoured vehicles in the Sokh enclave.

Fergana.Ru

Russia and Kyrgyzstan settle military issues

September 16, 2010

Kyrgyzstan will not increase the rent for Russian military facilities on its territory and wants to continue receiving payments in the form of military assistance, the Kyrgyz Defence Minister Abibilla Kudaiberdiyev said during his visit to Moscow. Previously, Kyrgyzstan said it wanted a four-fold increase in the $4.5 million rent that Russia pays for leasing military facilities in the country.

The countries also agreed to extend the term of deployment of Russia's military facilities to 49 years. By late 2010, Russia and Kyrgyzstan are to sign an agreement on cooperation between the Defence Ministries of both states. The parties also discussed the issue of combining all Russian military facilities in Kyrgyzstan into a United Russian Military Base.

Expert Online

Kazakhstan holds Peace Mission 2010 anti–terror drills

September 24, 2010

On September 9-25, Kazakhstan hosted the Shanghai Cooperation Organisation Peace Mission 2010 military exercise, at the Matybulak training range in Zhambyl region, designed to showcase the organisation's capabilities against extremism, separatism and terrorism. Peace Mission 2010 assembled 6,000 servicemen from China, Kazakhstan, Kyrgyzstan, Russia and Tajikistan and over 1,500 units of equipment, firepower and weapons systems. The anti-terror drills were attended by Defence Ministers of SCO member states.

The agreement on arranging the Peace Mission 2010 anti-terror drills in Kazakhstan was approved by Defence Ministers of the SCO member states in May 2008.

www.sco2011.kz

Chebarkul firing range hosts artillery drills

October 25, 2010

A joint operational tactical exercise of the Collective Rapid Reaction forces (CRRF) of the Collective Security Treaty Organisation, the Interaction-2010, began at Chebarkul range in Chelyabinsk Region of Russia on October 25. Over 1,700 servicemen and 270 units of military hardware participated in the drills.

The goal of the Interaction-2010 is training and tactical activities of the CSTO CRRF to contain an armed conflict in the CSTO region. The use of non-lethal weapons is going to become yet another novelty marking the event. It is the first time that the CSTO is holding its CRRF drills on Russian soil. Previous CSTO joint drills were held at the Matybulak range in Kazakhstan.

Kazakhstan Today

CSTO to improve its crisis response system

December 9, 2010

The Collective Security Treaty Organisation held a session of the Collective Security Council in Moscow to discuss issues of improving the efficiency of the organisation in the field of emergency response. The need for changes came after the tragic interethnic clashes in Kyrgyzstan in June this year, when the CSTO appeared to be incapable to take rapid measures.

Simply put, the CSTO was virtually prevented by Belarus and Uzbekistan from intervening in the crisis in Kyrgyzstan in June and an informal summit of the alliance in Yerevan in August had mandated that changes should be made in the statutes of the CSTO "to improve the efficiency in the field of emergency response". The heads of the CSTO member states have already prepared three sets of documents aimed at improving CSTO efficiency.

Thus, the statement on CSTO Peacekeeping Forces was signed and the declaration of CSTO member states was adopted. Changes were made to the Collective Security Agreement, Statute, Rules and Procedures, Provision on CSTO Bodies with the purpose to improve crisis response system. The participants of the session formulated a new document, the CSTO statute on crisis response, which governs the work of permanent bodies and provides for emergency consultations and the adoption of decisions to prevent (or settle) crisis situations.

According to new amendments, a rapid decision-making procedure was introduced in order to be able to arrive at a decision by means of videoconferencing or absentee voting and save time on convening emergency summits. Additionally, decisions may now be made on a limited basis, i.e. solely by the countries concerned, while disinterested parties will have the opportunity to maintain their neutrality.

Vedomosti

POLITICAL AND SOCIAL ASPECTS OF COOPERATION

Tajikistan drops Russian as official language

March 5, 2010

Tajikistan banned the use of the Russian Language by country agencies and in official documents to boost the role of the local language. A corresponding decision was taken by Tajik Parliament's Upper Chamber that ratified amendments to the law "On Regulatory Legal Acts". According to the amended articles, all laws and legal acts will now be published exclusively in Tajik.

Meanwhile Shavkat Saidov, an aide to the upper house speaker for public affairs said that the

Note: The Parliament of Tajikistan passed the new law "On State Language" in 2009. The law abolished the Russian language's status as the 'language of inter-ethnic communication', which had been provided for in the constitution. The new law obliged all nationals to know Tajik and speak it in official situations and public workplaces, while all government agencies, including courts and local authorities should issue official documents exclusively in Tajik.

Tajik President's national council may translate any of the legal acts to other foreign languages as the need arises.

Expert Online

RTR–Planeta to resume broadcasts to Tajikistan

August 21, 2010

Russia's RTR-Planeta TV channel is resuming its broadcasts to Tajikistan, suspended more than a year ago by the Tajik side. An agreement to this effect was reached by Russian and Tajik Presidents Dmitry Medvedev and Emomali Rakhmon during their recent meeting in Sochi on August 18.

Note: Tajikistan stopped airing the state-run RTR Planeta on March 2, 2009 due to unpaid fees by the Russian side. The Tajik side has increased their tariffs by 50% in 2009, justifying it by the increase in prices for electricity and equipment. Russia's VGTRK agreed to pay according to newly established rates; however, Tajikistan soon announced that Russia ran into debt of $7 million roubles and demanded repayment. RTR-Planeta was the only Russian-language broadcaster operating in Tajikistan.

RIA Novosti

Draft law on languages submitted to Verkhovna Rada

September 8, 2010

A draft law expanding the sphere of application of the Russian language in Ukraine has been submitted to the Verkhovna Rada.

The bill defines proactive measures in order to implement the status of regional languages for each of the regional languages in Ukraine and to secure the possibility for regional or minority language speakers in Ukraine to be able to use their language in the spheres of public life. In particular, the draft bill removes the existing threshold for official use of the Russian language in all major areas of public life – television, advertising, film industry, local administration, courts and education.

When the ruling Party of Regions, led by President Viktor Yanukovych, was campaigning for parliamentary elections, and when Mr. Yanukovych himself was running for the presidency, they promised voters to make Russian a second state language.

Ъ-Online

Key Macroeconomic Indicators of the CIS Countries in 2010

14

Elvira Kurmanalieva,

Gaukhar Ormantayeva

After a sharp decline in 2009, the world economy demonstrated signs of recovery in 2010. To support post-crisis economies, central banks of developed countries have kept their interest rates at low levels. The largest economy in the world – the US economy – continued to pursue a quantitative easing policy throughout the year. After some deceleration in July and August of last year, the US economy started to grow again after the second round of quantitative easing, which was approved by the Federal Reserve System in August 2010. Despite some growth, Eurozone countries have been struggling with their sovereign debt problems. The instability of the EU economy was further exacerbated by high interdependence of the Eurozone economies. Developing economies have been growing as well, with China being the growth engine in Asia, and Brazil being the growth rate leader in Latin America.

The CIS economies, which were growing steadily in the pre-crisis period, decelerated during the crisis, and, on average, grew by 4.2% in 2010. Economies of Uzbekistan, Turkmenistan, Tajikistan, Kazakhstan, Belarus, and Moldova experienced growth rates of more than 5%, while the largest economy in the region, Russia, grew by 4%. A key driver of economic growth in the CIS region was industrial production. On average, industrial production in the CIS countries increased by 7-11% in 2010 (except Azerbaijan, where industrial production grew by only 2.6%). After a significant drop in Moldova and Ukraine in 2009 (21.1% and 21.9%, respectively), the industrial sector grew by 7% in Moldova and 11% in Ukraine in 2010. On the other hand, the agricultural sector was the weakest link in the CIS economies. A dry, hot summer observed in the middle of last year led to bad harvest in a number of countries in the region. The largest decline in agricultural output was observed in Armenia (-13.5%), Russia (-11.9%) and Kazakhstan (-11.7%). Nevertheless, some countries in the region saw their agricultural sectors grow. Moldova experienced the largest increase in agricultural output among the CIS countries - it grew by 7.9% in 2010. In Tajikistan and Uzbekistan agricultural output increased by 6.8%, while in Belarus it increased by 2%.

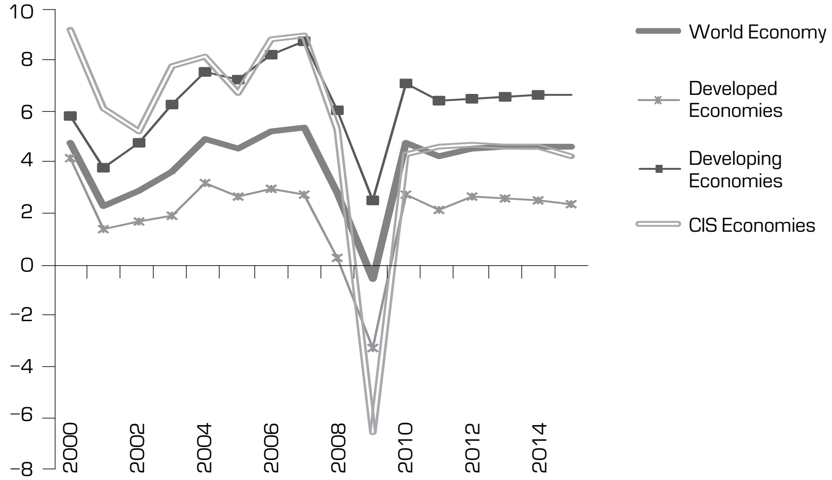


Figure 14.1. World GDP growth (%)

Source: World Economic Outlook, IMF

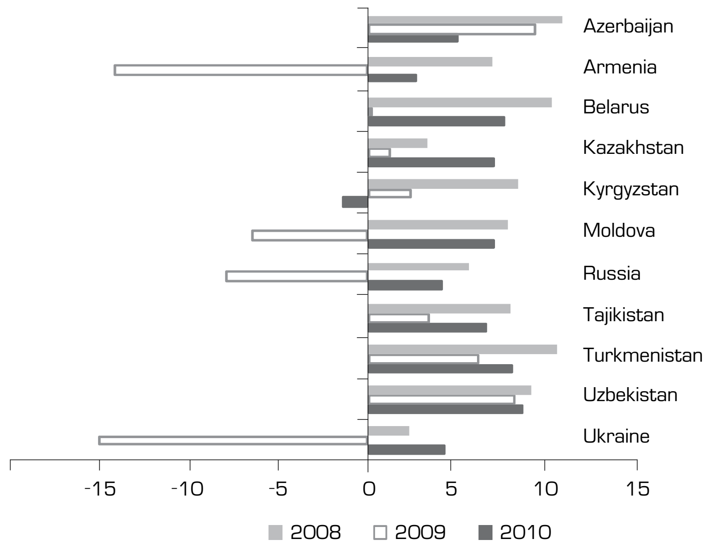


Figure 14.2. CIS economic recovery (GDP growth, %)

Source: CIS Statistical Committee

Since most of the CIS countries are commodity-exporters, positive dynamics of global commodity prices had a favourable impact on trade balance of these countries. As usual, fuel and energy products made up the bulk of exports in Azerbaijan, Kazakhstan, Russia, Turkmenistan and Uzbekistan. Azerbaijan, an oil and gas exporter, observed a positive trade balance of $14.7 billion in 2010. Kazakhstan being a major exporter of energy products has also experienced trade surplus ($29.5 billion) due to increasing export revenues. Commissioning of a gas pipeline to China at the end of 2009 and a rise in raw material prices (energy products, cotton, grain) led to a slight increase in Turkmenistan's exports, which by year end increased to

$9.7 billion from $9.6 billion in 2009. Uzbekistan, which joined the Turkmenistan–China gas pipeline, also benefited from this development, and thus experienced an 11% increase in exports. The temporary close-down of Kyrgyzstan's borders with neighbouring countries in the middle of last year reduced export revenues, but an increase of global metal prices in the second half of the year helped the country make up for some of these earlier losses. The spike in raw material prices, on the other hand, worsened trade balance of commodity-importing countries. A negative trade balance of $7.4 billion in Belarus was attributed to price increase of intermediate goods, such as energy products, materials and components. Due to a rise in wheat prices, which is Tajikistan's main import product, the country ended up with a negative trade balance of $1.5 billion in 2010. On January 1, 2010 the Customs Union (CU) between Russia, Belarus and Kazakhstan was launched. By the end of 2010, trade turnover between Belarus and its CU partners increased by 20.6%, trade turnover between Kazakhstan and its CU partners increased by 28.1%, and trade turnover between Russia and its CU partners increased by 18.9%. Nevertheless, these results have not yet leveled off with the pre-crisis figures. In 2009 the drop in trade turnover between Belarus and its CU partners was 31.1%, between Kazakhstan and its CU partners – 37.4%, between Russia and its CU partners – 32.5%.

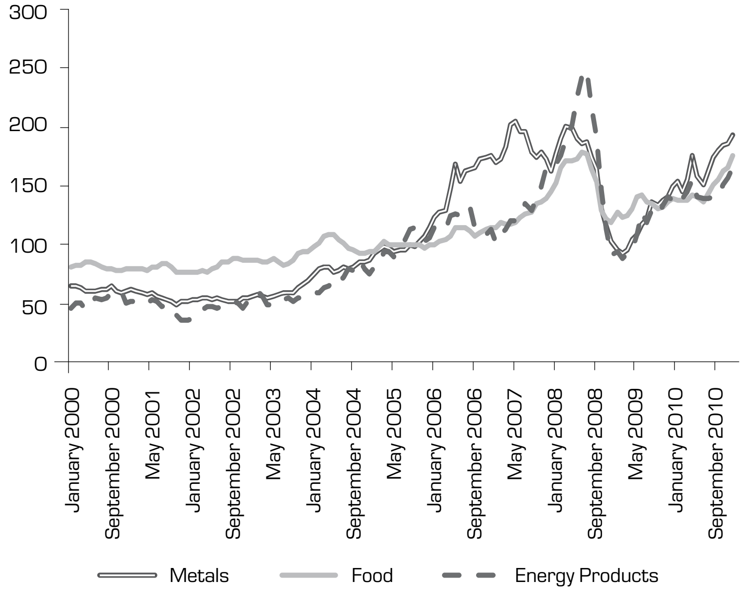


Figure 14.3. Commodity price dynamics: 2000–2010

Source: IFS, IMF

In 2010 all developing countries faced a major problem of high inflation. By the end of the year, the rise in global consumer prices averaged 3.8%. Since foodstuffs constitute a major part of the consumer price index, food inflation

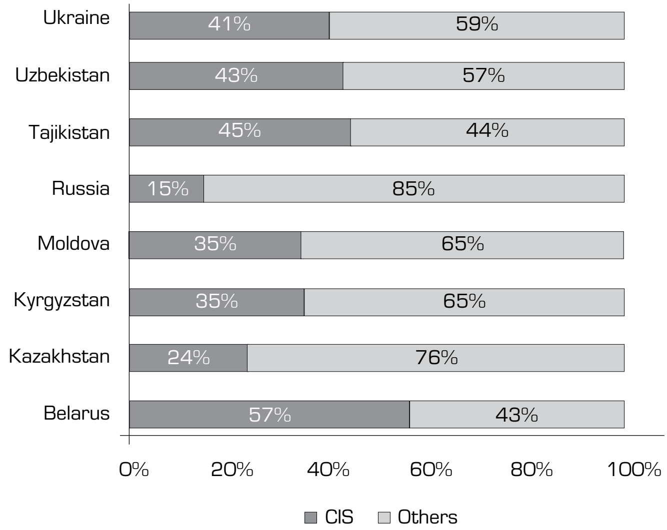


Figure 14.4. Geographical structure of trade turnover in CIS countries in 2010

Source: National Statistics

was a key driver of overall price increase. As had been the case in 2007, increase in food prices was mainly driven by long-term fundamental factors, such as improvement in overall economic conditions and population growth, which in turn led to increase in demand for food in developing countries; energy-saving policies in developed countries; and poor weather conditions that had a negative impact on agriculture (Trostle, 2008). Other factors include depreciation of the US dollar, a decline in global grain stocks, and introduction of export quotas in a number of food exporting countries. In many commodity-importing countries high prices on energy products increased the cost of agricultural output, which in turn increased domestic prices. Monetary and fiscal stimulus policies that were pursued in many countries in 2009 and 2010 also contributed to additional inflationary pressure.

Prices in the CIS region were rising even faster than in other countries. In the first half of last year, when prices were declining and annual inflation in the CIS region was at 5.8% in July 2010, it seemed that inflation will remain at low levels throughout the year. But as it was the case in 2007, economic recovery and growth of trade turnover observed were accompanied by the major problem of inflation. The most sharp price increase was observed in September, when average monthly inflation reached 2.9% in Ukraine and Kyrgyzstan, 1.9% in Tajikistan and 1.6% in Belarus. By the end of the year the highest rate of annual inflation was observed in Kyrgyzstan, where the annual price rise stood at 19.2%. Annual inflation rates in Armenia, Belarus, Tajikistan and Ukraine exceeded 9%, in Moldova and Russia – 8%, in Azerbaijan, Kazakhstan and Uzbekistan – 7%. Due to the fact that a number of countries, such as Russia and Kazakhstan, are major producers of agricultural output, unfavourable climate conditions contributed to a price rise. Dry summer led to bad harvests, which in turn led to a hike in the price of agricultural products. For countries that mainly import agricultural products, such as Kyrgyzstan and Tajikistan, increase in agricultural food prices served as an additional component in creating an inflationary pressure. For the region as a whole, inflation rate exceeded 8% in 2010, which far exceeds the rate of global inflation.

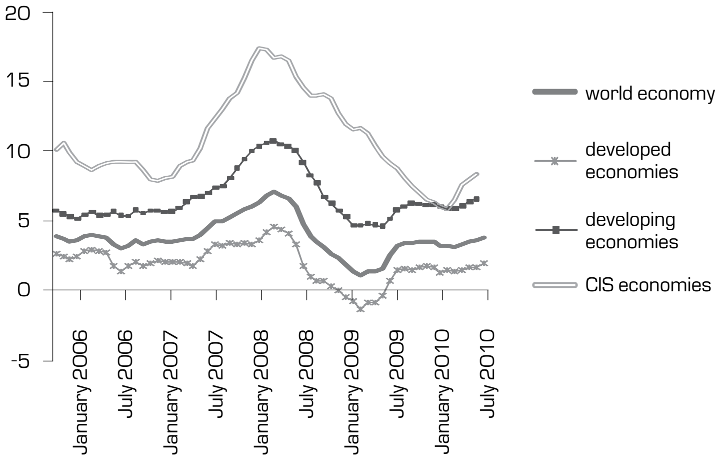


Figure 14.5. Global inflation (%, YoY)

Source: IFS, IMF

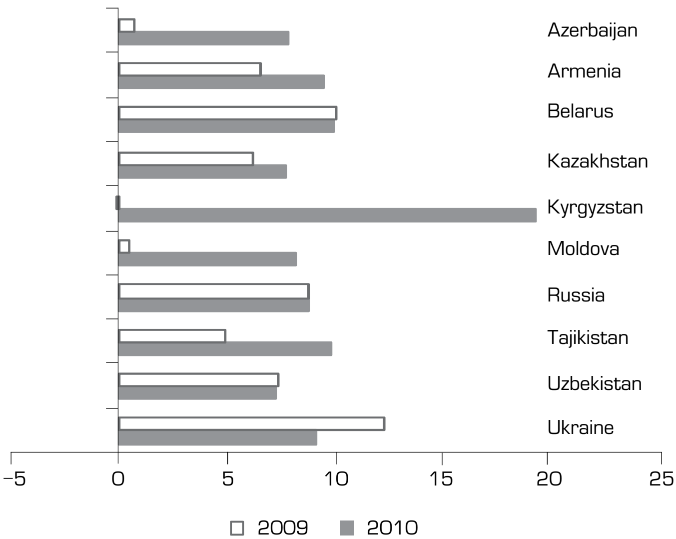


Figure 14.6. CIS inflation (%, December, YoY)

Source: IFS, IMF

In addition to a number of non-monetary factors that contributed to inflation, sharp expansion of money supply led to price increases in the region. This in turn forced central banks to adopt policies targeted at tightening money supply. Money supply of net-exporting countries was boosted through export earnings, while importing countries increased their money supply through rising external borrowing. In order to fight inflation, the National Bank of Azerbaijan increased its benchmark interest rate by 1%, while Armenia raised its REPO rate 5 times, which reached 7.25% by the end of the year. After the first signs of inflation were observed In Moldova, the National Bank of Moldova increased its benchmark interest rate by 1% and at the end of the year it reached 7%. High inflationary pressure persuaded the National Bank of Tajikistan to increase its refinancing rate at the end of 2010 by 0.25% to 8.25%.

In 2010 most countries in the region aimed their fiscal policies at mitigating the worst consequences of the global financial crisis, with the major part of budgets going into social expenditures. As a result, fiscal deficits were observed in almost all of the CIS countries. The government of Russia pursued an active fiscal policy by expanding social expenditures, which led to a sharp decline in the balance of the state budget. After a long period of state budget surplus, Russia observed a fiscal deficit for a second consecutive year, reaching a deficit of 3.6% of GDP in 2010. Financing of social expenditures was also a major part of budgetary spending in Belarus. By the end of 2010 the country's consolidated budget deficit averaged 2.6% of GDP. In Kyrgyzstan political events of the first half of last year had an additional burden on government spending. About half of government spending was directed towards measures to stabilise the economy, ensure safety and social security. As a result, Kyrgyzstan's budget deficit increased from 1.5% of GDP in 2009 to 5.1% of GDP in 2010. The budgetary spending in Kazakhstan was also aimed at supporting social needs, as well as at supporting the banking sector, which was significantly affected by the global financial crisis. As a result, the state budget deficit averaged 2.5% of GDP in 2010 compared to 1.4% in

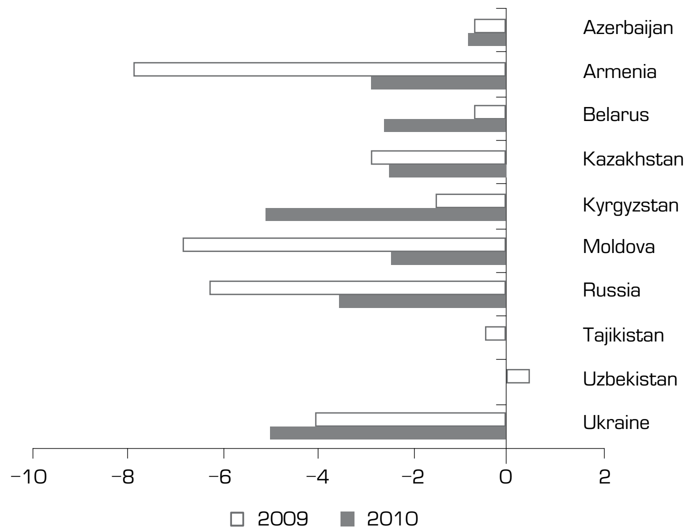


Figure 14.7.
State budget balance (% of GDP)

Source: CIS Statistics Committee

2009. Ukraine's state budget also resulted in a deficit, which was at 5.9% of GDP at year end. Despite implementation of economic reforms and hikes in utility prices, Ukraine's significant deficit was attributed to the country's soaring liabilities that were the result of servicing increasing government debt. As a consequence of a rise in budget deficits in 2009-2010, private investments in the region decreased. The CIS countries' need to finance their budget deficits from external sources led to a significant increase in their external debts.

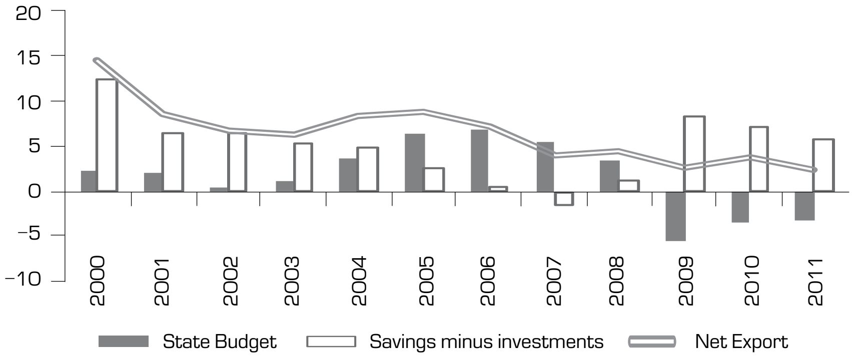


Figure 14.8. Savings and investments in the CIS: weighted average (% of GDP)

Source: National Statistics, expert estimations of IMF and EDB

In 2010 some positive changes were observed in the region's banking system. In most of the region's countries, banking indicators improved, including in the credit sector. The highest growth of the credit sector was observed in Uzbekistan, where the volume of credits to economy increased by 35%. In Armenia the credit portfolios of commercial banks rose by 29% by the end of the year. The volume of credits to economy increased in the range

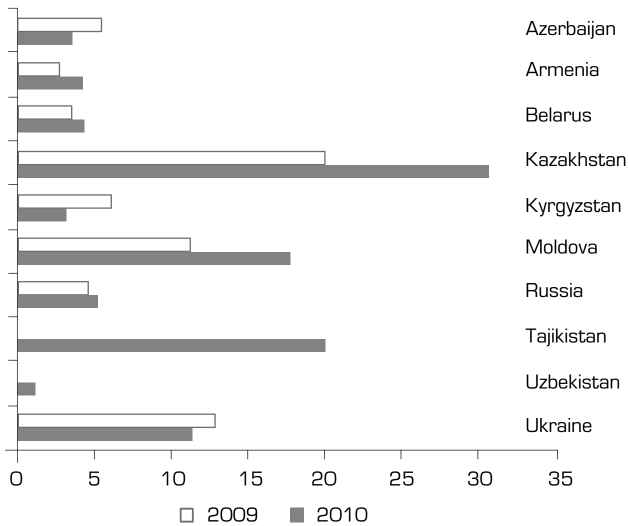


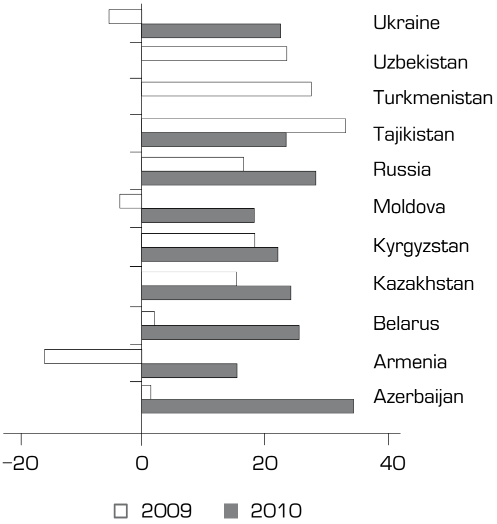
Figure 14.9. Non–performing loans (% of total)

Source: National Statistics, EBRD

of 9% and 14% in Azerbaijan, Moldova, Russia and Tajikistan. In Kyrgyzstan, where most of the credit activity is related to trade and agriculture sectors, the volume of credits provided increased by 4.6%. Despite this positive trend, it should be noted that a large proportion of the loan portfolios of countries in the region is made up of non-performing loans. In Tajikistan 40.9% of loans were non-performing. Overdue loans accounted for 11.2% of credit in Moldova, 11.9% in Ukraine and 4.7% in Russia. In Kazakhstan, the share of overdue credits is high despite a restructuring of the banking sector's external debt, where bad debt accounts for 26.4% of outstanding credit and written off loans account for 20%.

Figure 14.10.
Growth of monetary aggregate (M2) (%, December, YoY)

Source: National Statistics, IFS



Overall, 2010 results demonstrate a recovery of economic activity in both developed and developing countries. The CIS countries are no exception to this. In spite of the downturn in agricultural production in some of the region's countries, the growth of industrial production, private consumption and state investment became engines of economic growth. However, resolving such problems as high inflation, large budgetary deficits and increasing external debt, will require encouraging of continuous growth in the region.

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International and Regional Development Banks in Northern and Central Eurasia: Overview of Activities in 2010

15

Ella Baybikova

This paper aims at analysing the activities of international and regional development banks in the Central Asian states of Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, as well as Russia, Armenia and Belarus. The international financial organisations engaged in the region include the Asian Development Bank (ADB), the World Bank (WB), the Eurasian Development Bank (EDB), the European Bank for Reconstruction and Development (EBRD), and the Islamic Development Bank (IsDB). The legal ground for activities of any international development bank (IDB) in the country is, first of all, the country's membership in the bank, which is also provided with immunity and the status of international organisation.

Development banks provide medium- and long-term financing for capital-intensive projects that are not very attractive to private investors. At the same time, the implementation of these projects is of great importance to the country's economy. First of all, these are infrastructural projects that lay the foundations for the further development of industrial production and the provision of essential living standards including energy, transport, communications and municipal infrastructure. Some of the development banks also aim to support the social sector by financing projects in education and medicine, as well as the corresponding reforms.

Financing provided by the international development banks in 2010 exceeded the target value that was previously pledged in commitments to support the post-crisis development and stability of the banking sector. These support measures helped to prevent a crisis in the system and the collapse of monetary lending to the real economy. At the same time the region still faces a challenge in real sector credit financing and a high risk of possible aftershocks. Together with governments and the European interstate institutions, the IDBs are doing their joint best to solve the region's problems by providing local currency financing to unhedged borrowers and developing local capital markets.

The year 2010 is also notable for the IDBs' efforts to enhance the efficiency of their activities, which is studied in the "Improving the Organisational Effectiveness of Development Banks" section of the current paper.

It should be noted, however, that the annual reports for 2010 had not been published when this article was written, so it is based on the data published by the IDBs on their official websites. At the same time this paper does not aim to compare the quantitative index of investments.

Priority Areas of Activity in 2010

The major investment areas for international development banks have traditionally been energy, transport and transport infrastructure, which account for a considerable part of the sectoral structure of investment portfolios, as well as targeted financial support for small and medium-sized enterprises. For instance, transport projects account for 51% of the total ADB projects approved in 2010 in the countries of the region mentioned above, 78% of the IsDB projects and 31.5% of the IFC's projects in the region in 2010. Energy projects make up around 20% of the EBRD total financing, and 40% of the EDB project portfolio. Investments in the financial sector are also significant, with 13% of the ADB projects given to targeted microfinancing initiatives, 38.1% of the total IFC projects this year, 24.8% of EBRD total investments and a shade less of the EDB funding (18%).

Meanwhile, as the world is coping with the after-effects of the global financial and economic crisis, issues of energy efficiency, climate change and environment, as well as multilateral partnership between development institutions, are coming to the fore once again.

Environmental Issues and Mitigation of Climate Change

Leading international development banks (IDBs) and the International Monetary Fund (IMF) have mapped out an action plan to support sustainable global recovery and have agreed to finance the mitigation of climate change within the framework of the Copenhagen Agreement. In addition to the necessary anti-crisis support, the IDBs focus their attention on crisis prevention, supporting sustainable growth and development, and, especially, the need for taking measures against climate change. IDBs and the IMF supported the obligation undertaken by developed nations within the framework of the Copenhagen Agreement to provide developing countries with additional immediate financing of $30 billion in 2010-2012 and to raise another $100 billion by 2020 in order to help them cope with the consequences of climate change and substantially cut greenhouse gas emissions, which is a must to stop the global temperature rising. IDBs confirmed their intention to provide technical assistance to the UN process and underlined the importance of signing a legally binding international agreement on climate change prevention after 2012 as soon as possible. IDBs have the necessary expertise and capabilities to catalyse state and private resources in order to invest them efficiently in low-carbon technologies and projects for adapting to climate change in developing countries. The Clean Technology Fund (CTF) is ready to allocate $4.3 billion for co-financing the development and use of solar energy, environmentally safe municipal transport and other similar projects.

The First Asian Solar Energy Forum was held in Manila within the framework of the Asian Solar Energy Initiative (ASEI). The participants of the forum noted that multilateral development institutions, such as ADB with its development partners, are in a position to play a catalytic role in technology transfer facilitation and knowledge sharing for solar energy development. However, high initial capital investments in solar energy and the perception of high risks keep many investors from putting up the capital for solar energy developments. The Forum was organised by ADB in association with the International Energy Agency (IEA), the United Nations Industrial Development Organisation (UNIDO) and the Renewable Energy and Energy Efficiency Partnership (REEEP). ASEI will also establish and, initially, host the Solar Energy Forum, an international knowledge-sharing platform that will track solar development projects, discuss new solar power proposals and incentive mechanisms, and organise major conferences. ASEI will also be responsible for raising concessional funds from donor countries to partly mitigate the risks of the high up-front capital costs of investing in solar energy, as well as design other innovative ways to attract private-sector investment.

Climate Investment Funds (CIFs) are unique financing instruments designed to pilot low-carbon and climate-resilient development through an extended fund facility provided by the African Development Bank, ADB, EBRD, Inter-American Development Bank and the World Bank Group.

The Multilateral Carbon Credit Fund (MCCF) funded by the EBRD and the EIB is active in Central European and Central Asian countries. In 2010 the fund closed two deals for purchasing carbon credits (CO_2 emission quotas) in Armenia and Ukraine.

Energy Efficiency

Energy efficiency is of key importance to the sustainable development of the Eurasian region, which is characterised by relatively high energy intensity. In order to implement the corresponding programs and coordinate their efforts, development institutions are establishing strategic partnerships. The improvement of energy efficiency and reduction of energy consumption will boost the industry's competitiveness, release resources and cut CO_2 emissions. Investments in energy efficiency are usually spent on the replacement or modernisation of outdated production and heating facilities, the installation of metering equipment, thermal insulation, renovation of heat and electricity distribution systems, as well as different projects in the fields of biomass, biogas and solar energy. Energy-intensive sectors such as the production of building materials, the food-processing industry and light industry are usually the principal choices for investment.

In particular, the Eastern Europe Energy Efficiency and Environment Partnership (E5P) Fund was founded in 2009 and, a year later, began to finance projects in the fields of improving the energy efficiency of central heating, waste water treatment and waste management, including waste-to-energy projects. The partnership unites the Nordic Investment Bank (NIB), European Investment Bank (EIB), EBRD, WB, IFC and the Nordic Environment Finance Corporation (NEFCO), as well as the European Commission and the government of Sweden, and receives strong political support especially from Denmark, Norway and the Baltic states.

According to the IFC report "Energy Efficiency: A New Resource for Sustainable Growth" published in 2010 around 70% of Ukrainian industrial companies could reduce production costs by raising the energy efficiency of their production facilities, which would also help raise their competitiveness under the post-crisis conditions. The report also recommends to improve planning and control over energy consumption at industrial companies, as well as widening awareness of the benefits received through financing energy efficiency projects.

The EBRD and the Japan Bank for International Cooperation (JBIC) signed a memorandum of understanding to support economic and social development in Central and Eastern Europe, Russia, the Caucasus and Central Asia, with a special focus on energy efficiency and climate-related projects.

Under the Memorandum, the EBRD and JBIC will cooperate in co-financing environmental projects, the development of carbon emission reduction instruments, co-financing of large infrastructure and corporate projects, and the non-sovereign financing of municipal infrastructure, that are linked to climate-related projects in particular, as well as local currency financing in the region.

In addition, development institutes are implementing local energy efficiency programs, aimed at solving highly specialised problems. For instance, IFC – a member of the World Bank Group, – in partnership with the Ministry for Foreign Affairs and the Ministry of Employment and the Economy of Finland, is implementing a new Russia Residential Energy Efficiency Advisory

Services Project, which aims to stimulate investment into the energy-efficient renovation of residential multifamily buildings and to reduce CO_2 emissions in Russia. Energy consumption in residential housing could be halved, which would reduce CO_2 emissions by approximately 150 million tons per year. The project will create an effective legal and institutional platform to support local homeowner associations and housing management companies in obtaining access to financing.

The Asian Development Bank (ADB) is active in implementing energy efficiency projects in Central Asian countries. So, ADB signed an agreement with the Uzbek Finance Ministry to boost the efficiency of Uzbekistan's electricity supply through the construction of Central Asia's first 800 mW combined cycle gas turbine (CCGT) power plant and an array of other projects. The government of Uzbekistan has put energy saving and improving the energy efficiency of industrial companies at the top of its economic agenda.

Multilateral Partnership

The year 2010 is notable for the launch of several large-scale investment projects, jointly financed by several international and national development banks, as well as commercial banks.

The EBRD, IFC, and FMO (the entrepreneurial development bank of the Netherlands) have joined up with Asia Debt Management Hong Kong (ADM Capital) to establish the ADM CEECAT Recovery Fund to invest in mid-size companies facing financing difficulties as a result of the financial crisis.

The ADM CEECAT Recovery Fund, targeting Central and Eastern Europe, Central Asia and Turkey, will help the region recover from the crisis by supporting companies that represent a major source of jobs and significantly contribute to economic development.

The EBRD will invest €60 million, IFC €35 million, and FMO €15 million in the targeted €300 million ADM CEECAT Recovery Fund, which will be managed by ADM Capital.

The fund's investments will focus on rehabilitating operationally strong but financially distressed companies via restructuring, rescheduling, refinancing, debt-equity swaps and liquidity management. It will also fund growth opportunities where alternative sources of capital are not available.

The EBRD, EIB and IFC, and the shareholders of Nabucco and Nabucco Gas Pipeline International GmbH signed a mandate letter that marks the start of the appraisal process of the Nabucco project, a required step towards a potential financing package of up to €4 billion. The Nabucco gas pipeline project is the flagship project for meeting future EU gas demand and will diversify Europe's pool of supplier countries. The potential financing package will consist of up to €2 billion from the EIB, up to €1.2 billion from the EBRD (up to €600 million for the EBRD's account and up to €600 million to be syndicated to commercial banks) and up to around €800 million from IFC (up to €400 million for the IFC account and up to €400 million to be syndicated to commercial banks).

The involvement of the three international financial institutions (IFIs) is a demonstration of global and European support for the project and represents an important milestone in ensuring the overall financing of Nabucco. The early involvement of the IFIs will support Nabucco in meeting the highest standards in environmental and social risk evaluation and procurement. The appraisal of the project will include a thorough assessment of commercial, social and environmental aspects. The Nabucco gas pipeline project addresses the EU's priority goal of achieving energy security via the diversification of gas routes and gas supplies.

The IDBs have also supported the project for the expansion and modernisation of St. Petersburg's Pulkovo International Airport on the basis of a public-private partnership. The total loan financing package of approximately €716 million will be provided by IFC, EBRD, the EDB, NIB, the Black Sea Trade and Development Bank (BSTDB), Russia's Vneshekonombank, and several commercial banks.

Moreover, the IsDB joined the IFIs' working group on counteracting corruption.

Improving the Organisational Effectiveness of Development Banks in 2010

Asian Development Bank

In 2010 the ADB made efforts to enhance the effectiveness of its activities in accordance with the recommendations made in the Development Effectiveness Review 2009, paying special attention to co-financing, supporting educational programs and boosting the developmental impact of implemented projects.

Thus, the ADB spurred its work with donors on attracting them to joint funds and establishing new funds. The ADB launched a multilateral Urban Financing Partnership Facility to help drive environmental infrastructure improvements in urban centres, with the government of Sweden the first to inject funds. In 2010 the government of Spain provided an additional $5 million each to the ADB-administered Water Financing Partnership Facility (WFPF) and Clean Energy Financing Partnership Facility (CEFPF). The government of Luxembourg has committed a further €1.5 million to another ADB fund, the Financial Sector Development Partnership Fund. The ADB and ASEAN nations, along with the People's Republic of China, Japan, and the Republic of Korea, established a jointly owned Credit Guarantee and Investment Facility (CGIF), as a trust fund of the ADB with initial capital of $700 million, including the ADB's contribution of $130 million and a combined $570 million from the ASEAN+3 governments.

The ADB returned to the US dollar bond market twice this year with the pricing of a $2.5 billion five-year global benchmark bond issue and a $3 billion three-year global benchmark bond issue, proceeds of which were used in the bank's non-concessional lending operations.

In 2010, the ADB initiated the modernisation of business processes in order to improve the quality and efficiency of its operations, as well as reduce expenditure. Moreover, the ADB launched a human resources plan, Our People Strategy, to be more transparent in staff recruitment, compensation and promotion. The strategy foresees the introduction of a collective assessment scheme aligned with the regular monitoring of project implementation. The ADB will be recruiting a significant number of new staff, both internationally and locally over the next three years. Our People Strategy provides the framework for ensuring ADB has high-calibre, motivated people with technical and interpersonal skills that match client needs, managers who are inspiring, proactive and accountable, and a workplace environment to support them. Our People Strategy will guide ADB human resources management until 2015.

ADB reviews its public relations policy every five years. In 2010, the bank began a regular review process to improve the policy's efficiency, transparency and relevancy. The renewed public relations policy will be approved by the Board of ADB directors in 2011 after a series of public discussions and consultations.

Table 15.1. ADB projects in 2010 in the region by sector (loans)

Sector	Armenia	Kazakhstan	Kyrgyzstan	Tajikistan	Russia	TOTAL
	$ million					
Agricultural, irrigation, water supply	-	-	-	-	140	**140**
Transport infrastructure	210	456	-	-	115	**781**
Microfinance	-	150	-	-	50	**200**
Energy, ecology	-	-	16.7	-	340	**356.7**
Economic, municipal, infrastructure services	-	-	48.5	-	-	**48.5**

ADB's investment priority in the region is the development of transport corridors within the framework of the Central Asia Regional Economic Cooperation (CAREC) Program. ADB has served as CAREC's Secretariat since 2000. In 2010 Pakistan and Turkmenistan joined the organisation. Starting 2001, around $10.4 billion was invested in the transportation sector within the framework of the CAREC Program, including $219 million for trade facilitation, and $2.5 billion for energy projects.

World Bank Group

In order to support the new post-crisis strategy of the World Bank Group (WBG) and a comprehensive reform package to make the bank faster, more flexible and more accountable, the WBG shareholders approved the first general capital increase for the World Bank for more than 20 years.

This measure included the increase of $86.2 billion in capital for the International Bank for Reconstruction and Development (IBRD) – the arm that lends to developing countries – from a general capital increase and a selective capital increase linked to the change in voting powers; this includes $5.1 billion in paid-in capital; a $200 million increase in the capital of the IFC – the WBG's private sector arm – as part of an increase in shares for developing and transition countries. The IFC will also consider raising additional capital subject to board approval by issuing a hybrid bond to shareholding countries and by retaining earnings. The voting power of Developing and Transition Countries (DTCs) at IBRD was increased to 47.19%. The IBRD 2010 realignment resulted from a selective capital increase of $27.8 billion, including paid-in capital of $1.6 billion. The voting power of Developing and Transition Countries at IFC was increased to 39.48%. The IFC 2010 realignment resulted from a selective capital increase of $200 million and an increase in the basic votes for all members. The IBRD and IFC shareholdings will be reviewed every five years.

The World Bank Group opened free access to its statistical databases and challenged the global community to use the data to create new applications and solutions to help poor people in the developing world. The WBG provided free, open and easy access to its comprehensive set of data on living standards around the globe – some 2,000 indicators, including hundreds that go back 50 years. Drawing from numerous data sources and working with statistical partners, the WBG has worked intensively to modernise its storehouse of statistics to create data.worldbank.org, a new, user-friendly data access site.

In 2010 the WBG commenced the development of a new energy strategy a framework for rendering assistance to developing countries in improving access to energy sources, and boosting the transition to a more environmentally friendly scheme for developing energy. The new energy strategy may be approved in 2011. The bank also held broad consultations on its new environmental strategy to discuss challenges and opportunities of environmentally sustainable growth and development, the bank's role in meeting these challenges and making use of opportunities, as well as ways of reaching a balance between economic development and ecological safety, and many other issues.

The World Bank is taking active part in environmental initiatives. In 2010 the bank launched two new climate programs - Scaling-up Renewable Energy Program for Low Income Countries (SREP) and Forest Investment Program (FIP). Both programs receive financing via the Strategic Climate Fund (SCF) – one of two trust funds established within the framework of international Climate Investment Funds (CIF). The Clean Technology Fund (CTF) has supported investment plans for Columbia, Indonesia, Kazakhstan and Ukraine.

Also in 2010, the World Bank published the intermediate outcomes of its water strategy implementation, which was adopted in 2003 and focuses on improving the quality of drinking water and solving problems of growing hydrological instability due to climate change. In addition to an array of successful projects in the water sector, the bank achieved progress in improving sanitation in countries with limited access to water.

IFC, a member of the WBG, has also financed a set of investment projects in 2010 that add to the WBG's operational effectiveness.

Table 15.2.
IFC projects in 2010 in the region by sector (loans)

Sectors	Armenia	Belarus	Kazakhstan	Kyrgyzstan	Tajikistan	Russia	TOTAL
	$ million						
Finance & Insurance	8	10	-	-	-	516	**534**
Accommodation & Tourism Services	-	-	-	-	-	40	**40**
Transportation and Warehousing	-	-	-	-	-	441	**441**
General	-	-	-	-	-	250	**250**
Construction and Real Estate	9	-	-	-	-	41.66	**50.66**
Nonmetallic Mineral Product Manufacturing	-	30	-	-	-	-	**30**
Electric Power	-	-	40	-	-	-	**40**
Other	-	5	2	7.8	1.3	-	**16.1**
TOTAL	**17**	**45**	**42**	**7.8**	**1.3**	**1288.66**	**1401.76**

European Bank for Reconstruction and Development

The shareholders of the EBRD have decided to increase the bank's capital by 50% and so pave the way for a rise in EBRD investments over the next five years as the region emerges from the sharpest throes of recession. The bank's Board of Governors approved the capital increase in the context of their overall endorsement of the bank's strategy for the period 2011-

2015. As a result, the bank's capital will rise to €30 billion from €20 billion, via a temporary increase in callable capital of €9 billion and a transfer from reserves to paid-in capital of €1 billion. The EBRD's strategy for the next five years envisages a continued high demand for the bank's investments. The New Growth Agenda aims specifically to address economic vulnerabilities that were unmasked in the region during the crisis, particularly, imbalances such as the mismatch between external and domestic sources of financing, the continuing lack of diversification within the economies of the region and the need for a strong focus on energy efficiency to boost competitiveness and achieve low-carbon growth. In the broader context of investments over the next five years, there will be a significant focus on tackling energy efficiency, climate change and helping to ensure energy security as well as accelerating transition in the infrastructure sectors. EBRD via its investments in the corporate sector, the also supports the further diversification of economies, helping to reduce some countries' dependence on raw materials or a limited number of product groups. The bank invests in infrastructure, paying special attention to projects in the fields of energy efficiency and continuity of power supply. The West Balkans and less developed countries of the Caucasus and Central Asia are among the bank's priority investment directions.

The EBRD has launched an initiative to develop local currency and capital markets in the region of its operations in order to help reduce unhedged foreign currency borrowing and the region's dependence on external capital, which have emerged as the key vulnerabilities in the EBRD region during the global economic crisis. The Local Currency and Local Capital Markets Initiative aims to support and complement the actions of many governments in the region, which are helping to build up local sources of domestic funding and reduce the use of foreign exchange in the domestic financial system. Crucially, the initiative does not look at promoting the use of local currency in isolation, but at the overall macroeconomic, regulatory and market framework to ensure long-term, sustainable and liquid local currency markets.

In 2010 the EBRD stepped up its work with co-investors. For instance, Taipei increased its support for the EBRD projects by contributing $2 million in additional financing to the bilateral Taiwan Business – EBRD Technical Cooperation Fund and the multi-donor Early Transition Countries Fund.

Last year the EBRD issued $1 billion five-year global bonds to finance its operations and widened its range of products. In particular, the bank together with Daiwa Securities Group introduced new EBRD microfinance bonds. The funding will be raised under the EBRD's Global Medium Term Note Program. Proceeds will support EBRD operations to fund financial institutions that provide microfinance to small businesses. The inaugural issuance of EBRD's Microfinance Bonds will be arranged by Daiwa Capital Markets and distributed by Daiwa Securities Co. Ltd. to Japanese retail and institutional investors.

Another novelty of 2010 was the new rouble interest rate swap derivative instrument, Overnight Index Swaps (OIS). An OIS gives Russian market participants the possibility for the first time to manage overnight interest rate risk exposure in roubles without using cash assets or resorting to currency swaps. The use of the OIS in Russia was made possible by the launch of the Rouble Overnight Index Average (Ruonia), which is calculated on a daily basis by the Central Bank of Russia, based on the contributions of 31 banks. Ruonia is the Russian equivalent of the Euro Overnight Index Average (Eonia), a weighted average of all overnight unsecured lending transactions made by 57 contributing banks in the Euro area's interbank market. The Eonia index is calculated by the European Central Bank.

Moreover, the EBRD launched an online training facility under its Trade Finance Program for EBRD member issuing banks. The training facility will provide courses to banks in 29 countries from Central Europe to Central Asia, aiming to ensure bank staff have the requisite skills to issue, process and honour traditional trade products in line with the International Chamber of Commerce trade rules.

In order to improve its operating activities, the EBRD initiated reorganisation of its management structure and created the position of Managing Director for Russia. Unfortunately, EBRD operations in Russia were overshadowed by the investigation into the alleged criminal activities of a group of Russian bank officials.

The results of the EBRD activities are reflected in the following table 15.3.

Sector	Armenia	Belarus	Kazakhstan	Kyrgyzstan	Tajikistan	Russia	TOTAL
	$ million						
SME	13	-	-	5.4	2	-	**20.4**
Lending to banks, financial institutions	55	-	50	1.4	-	554	**660.4**
Equity in banks	2.4	-	-	-	-	148	**150.4**
Energy efficiency and climate change	7	-	-	-	-	237.5	**244.5**
Non-bank financial institutions	4	-	-	-	-	16	**20**
Agribusiness	-	-	-	-	8.9	56.765.6	
Municipal and environmental infrastructure	-	-	62.9	-	10	11.3	**84.2**
Equity funds	-	-	49.5	-	-	50	**99.5**
Property and tourism	-	-	-	-	-	89	**89**

Sector	Armenia	Belarus	Kazakhstan	Kyrgyzstan	Tajikistan	Russia	TOTAL
	$ million						
Natural resources	-	-	-	-	-	87	**87**
Power and energy	-	-	-	-	-	649.3	**649.3**
Transport	-	-	285.2	-	-	398.9	**684.1**
Telecoms, informatics and media	-	-	14	-	-	14.6	**28.6**
Treasury	-	-	-	-	-	138.8	**138.8**
General manufacturing, Manufacturing and Services	-	3.5	8	-	1.7	320	**333.2**
TOTAL:	**81.4**	**3.50**	**469.6**	**6.8**	**22.6**	**2771.1**	**3355**

Table 15.3. EBRD projects in 2010 in the region

Islamic Development Bank

For the Islamic Development Bank (IsDB), 2010 was a year of active work with its member states. The bank held consultations with each of its member states on working out cooperation agreements in line with the country's key priorities. The partnership strategy is part of the bank's new business model, which aims to improve the interaction of the IsDB with its member states, introduce a strategic approach to regulating the bank's activities on development financing in these countries, and aid the implementation of the IsDB Vision 2020 strategy.

Sector	Kazakhstan	Kyrgyzstan	Tajikistan	Uzbekistan	TOTAL
	$ million				
Transport infrastructure	-	17.3	20	167.2	**204.5**
Rural education	-	-	-	11.7	**11.7**
SME	-	0.7	-	-	**0.7**
Agriculture	30	0.5	10	-	**40.5**
Energy and electricity	-	-	4.05	-	**4.05**
TOTAL	**30**	**18.5**	**34.05**	**178.9**	**261.45**

Table 15.4. IDB projects in 2010 in the region by sector (loans)

In 2010 the IsDB approved a capital increase from the current 16 billion to 18 billion Islamic dinars. Moreover, the IsDB board of governors approved the increase of Nigeria's subscription in the IsDB capital to reach 1.384 billion Islamic dinars (about $600 million). Following that increase, Nigeria was afforded the right to appoint a permanent executive director representing it on the board of executive directors, subject to paying the first share of the announced subscription in IsDB capital. Therefore, the Board of IsDB Executive Directors will be immediately widened from 16 to 18 members, with nine of them being appointed to represent major shareholding member countries and the other nine elected by the Board of Governors.

In order to finance planned growth in IsDB operations, the bank has successfully updated its Sukuk Trust Certificate Issuance program and increased the ceiling of the program from $1.5 billion to $3.5 billion.

The results of the IsDB investment activities in the region are listed in the table 15.4.

Eurasian Development Bank

The institutional development of the Eurasian Development Bank (EDB), the youngest development bank, has continued throughout 2010. Belarus completed the procedures required for joining the EDB, and became the fifth full member. The bank signed agreements on the terms of its presence and investment activities in Armenia, Tajikistan and Belarus, and opened representative offices in Minsk and Yerevan.

The EDB became a member of the two leading international professional associations: the International Swaps and Derivatives Association (ISDA[1]) and the International Capital Market Association (ICMA[2]). Membership of these associations enables the EDB to perfect its system of market risk management on an ongoing basis in line with current market trends, and play an active role in preparing and discussing respective regulations.

The EDB also widened its range of products by approving the Program of Trade Financing Instruments and Development of Mutual Trade, and the Program for Supporting the Development of Small and Medium-Sized Enterprises, aimed at securing loans for real sector businesses by providing target credit facilities to financial institutions.

Moreover, the EurAsEC Anti-Crisis Fund (ACF) was put into operation. The ACF was established in 2009 by six states of the region. The ACF mission is to help its member states overcome the implications of the global financial crisis. The EDB has been appointed manager of the ACF.

In order to expand funding of its investment operations, the EDB had its Euro-Commercial Paper Program registered for a total of $3.5 billion. The purpose of the program is to raise financial market resources for a term of up to one year.

The results of the EDB investment activities in the region are listed in the table 15.5.

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[1] *International Swaps and Derivatives Association (ISDA) was founded in 1985 and now has membership of more than 800 entities from 57 countries. The ISDA specialises in identifying and reducing risks associated with derivatives.*

[2] *International Capital Market Association (ICMA) was founded in 1969 and has about 350 members from 45 countries. Since its inception the ICMA has played a central role in creating the global framework for the operation of financial markets based on the rules and recommen–dations of the modern economy and production.*

Sector	Armenia	Belarus	Kazakhstan	Tajikistan	Russia	TOTAL
	$,million					
Finance (including Direct Investment Funds)	50	50	-	3	75.1	**178.1**
Agriculture	30	-	106.5	-	-	**136.5**
Transport	-	-	-	-	90	**90**
Extractive productions (including metals)	-	-	48.7	-	-	**48.7**
Energy	-	-	385	-	44.2	**429.2**
Chemicals, oil and gas	-	-	-	-	100	**100**
TOTAL	**80**	**50**	**540.2**	**3**	**309.3**	**982.5**

Table 15.5. EDB projects by sector in 2010

IFI projects in 2010 in the region by country

Armenia

The **Asian Development Bank** provided a loan to help build a new terminal at Zvartnots International Airport in Yerevan, Armenia, helping the airport to increase the number of destinations it serves and boost the frequency of flights. By the time the terminal opens in 2012, the airport should be able to handle about 3.2 million passengers a year, up from the current 1.8-2.0 million. This project is crucial for a landlocked country. The financing of the project will reach $40 million.

In 2010 the **EBRD** contributed around $80 million in financing, including to Armenia's financial sector projects and a carbon credits deal within the framework of the Multilateral Carbon Credit Fund. The EBRD has agreed to buy carbon credits from a group of ten small hydropower plants in Armenia, bundled into a single project under the Clean Development Mechanism (CDM) framework.

The Eurasian Development Bank embarked on full-scale work in Armenia in 2010. The bank provided funding to two banks under its SME support program, and financed a grain export deal to enhance food security. In 2010 the EDB provided a total of $80 million for Armenia.

The World Bank Group focused its attention on infrastructural gaps in transportation, education, healthcare and water supply areas in Armenia in 2010. In particular, the WBG approved financing for a road rehabilitation project to drastically improve the accessibility of the country's main road network for the rural population and to create employment. It will also help Armenia mitigate the impact of the global economic crisis on the country's economy.

The bank also supports the health system modernisation project to widen primary healthcare services on the basis of family medicine. Moreover, the International Development Association (**IDA**, a member of the WBG) and the

International Bank for Reconstruction and Development (**IBRD**, a member of the WBG) provided loans of $21 million and $4 million respectively to provide assistance to the poor and support development of human capital assets in Armenia.

IFC (a member of the WBG) launched the Armenia Sustainable Energy Finance Project, which aims to establish a sustainable market for energy efficiency and renewable energy investments and contribute to Armenia's energy self-sufficiency by working with local and international financial institutions. Established in January 2010, the program is supported with funds from the Austrian Ministry of Finance. Moreover, the IFC opened credit facilities for real estate and financial sectors to support financial institutions and SMEs.

Belarus

According to the IMF statement made after the Article IV consultations with the Belarusian authorities in November 2010, Belarus avoided a recession and resumed economic growth but there are still serious vulnerabilities. The first order of business should be to reduce the current account deficit. The IMF also welcomed the authorities' initiatives on further economic liberalisation and the promotion of entrepreneurship focusing on the development of small and medium enterprises.

The **World Bank** has approved a $42.5 million loan and a $5.5 million Global Environment Facility (GEF) grant for the Integrated Solid Waste Management Project for the Republic of Belarus. The project will strengthen national capacity for managing hazardous waste, and support Belarus in meeting its obligations under the Stockholm Convention on Persistent Organic Pollutants.

What is more, the World Bank has approved a $150 million loan for Belarus for a road upgrading and modernisation project, which will help develop Belarusian transport infrastructure on a strategic transit corridor and introduce electronic tolling. The project is part of the Belarus government's Roads of Belarus National Transport Development Program, which covers the period 2006-2015. Implementation of the project will start in 2011 and will take four years.

The **EBRD** and **IFC**, a member of the World Bank Group, have agreed to make a convertible loan totalling $8.5 million ($3.5 and $5 million respectively) to finance the construction of a greenfield detergent plant in Belarus. The project is topical for Belarus as over 90% of detergents are imported, mainly from Russia and Poland.

Moreover, the IFC provided a $30 million corporate loan to the Belarusian Alutech Group of companies engaged in the nonmetallic mineral product manufacturing sector. The proposed transaction will support the company's strategic growth through vertical integration, cost optimisation and operational efficiency.

In 2010 the Republic of Belarus paid its share in the charter capital of the **EDB**, thus completing the procedures required for joining the EDB, and became the fifth full member. The EDB opened a representative office in Minsk and embarked on investment activities in Belarus. The bank agreed to provide $99.8 million for the construction of Polotsk hydroelectric power plant in Belarus. The project envisages the construction of hydropower stations on the Western Dvina River. The EDB's funds will be used to finance the hydraulic complex of the Polotsk plant including design, construction, equipment and spare parts, assembly, pre-commissioning, testing, commissioning and personnel training.

Besides, the EDB supports projects for delivery of spare parts for assembling multi-purpose loaders, public cleansing vehicles and excavators to be sold in Russia and other CIS countries, which will promote cooperation between the two major machinery manufacturers, and boost commodity turnover between Russia and Belarus. The bank also provided $50 million for SME and trade financing projects.

Kazakhstan

The financial crisis has emphasised the challenges currently faced by Kazakhstan, such as strong dependence on primary industries and commodity exports, and the banking system's excessive reliance on foreign capital markets, as well as the need to accelerate the development of its energy and transport infrastructure.

The **EBRD's** Board of Directors has adopted a new strategy for Kazakhstan, which reinforces the bank's commitment to further support the Kazakh economy and sets out the priorities for its activities in the country over the next three years. The bank will support the development of the private sector by financing projects promoting innovation, best business and environmental practices, as well as energy efficiency. In order to help diversify the country's economy, the EBRD intends to invest up to $1 billion in projects that will be selected by the bank in close cooperation with Kazakhstan's Industry and Trade Ministry and Samruk-Kazyna National Welfare Fund. In this regard, the parties signed a trilateral memorandum of understanding, according to which the parties will cooperate in selecting, preparing and implementing different industrial and infrastructural projects in Kazakhstan. The choice of projects will be determined by their sound market principles and economic efficiency.

In 2010, the EBRD invested a total of around $470 million in various economic sectors in the country. The bank assisted the implementation of projects for the renewal of railway rolling stock and the modernisation of

Kazakhstan's railway network, restoration of the water supply and sewerage system in Aktau and Shymkent, as well as enhancement of urban transport in Almaty. The EBRD finances the construction of an oil and gas field chemicals production plant in Kazakhstan and the completion of exploration works at Petrolinvest's main oilfields. The bank's projects in the financial sector are aimed at supporting Kazakhstan's exporters and importers when financing of the real economy remains limited.

Moreover, the EBRD and Samruk-Kazyna National Welfare Fund have established the Kazakhstan Capital Restructuring Fund (KCRF), to the amount of $121.5 million to help Kazakhstan's companies restructure their debts. KCRF will be capitalised with $100 million at the first closing, with the EBRD and KCM each committing $49.5 million and ADM Capital investing 1%. The fund is expected to increase its capital base by attracting additional investors.

In 2010 the **ADB** investments in Kazakhstan topped $606 million, including $456 million for the implementation of two large-scale transport projects within the framework of the MFF–CAREC Transport Corridor investment program: Western Europe–Western China International Transit Corridor section in Zhambyl region, Project 3 ($173 million) and the Aktau–Beineu Road, Project 1 ($283 million). The bank also supports the SME project, which aims to widen access to medium-term financing for small and medium-sized enterprises via the local banks. The first tranche will make up $150 million.

The **World Bank** approved a $17 million loan for the Kazakhstan Tax Administration Reform Project (TARP). The project, with an overall value of $57 million, is co-financed by the government of Kazakhstan (to the tune of $40 million). The project will facilitate efforts to make the Tax Administration more efficient and effective through the introduction of modern standards. Moreover, the World Bank provided a $29.2 million loan for the Technical and Vocational Education Modernisation Project for Kazakhstan. The Kazakh government co-financed the project in the amount of $4 million.

The **IFC** provided financial support for three projects in Kazakhstan in 2010 at a total sum of $42 million. The loan for $40 million was provided to JSC Central-Asian Electric Power Corporation (CAEP Co.) to finance its comprehensive investment plan to support major energy efficiency and environmental improvements and support its growth strategy. The $2 million went to Ust Kamenogorsk Poultry Farm, JSC.

The Eurasian Development Bank increased its investment portfolio by $540 million. The bank took part in a large-scale investment project for construction of a third power unit at the Ekibastuz GRES-2 power plant to help restore the unity of Russia's and Kazakhstan's power grids. Moreover, the EDB proceeded to finance the construction and launch of a new production facility with a full production cycle, from ore mining and dressing to metal tin production. The implementation of this project will effectively create a new sub-sector in the country's non-ferrous metallurgy. Along with that the bank financed export-oriented projects in the republic's agricultural sector.

The **Islamic Development Bank** invested around $30 million in leasing transactions in the agricultural sector.

Kyrgyz Republic

In April–June 2010, Kyrgyzstan faced widespread social and political instability that had a negative influence on the country's economic development. Bishkek hosted the international donors' conference, during which the representatives of the Kyrgyz government, civil society, private sector, international development organisations and bilateral donors discussed the role of each partner in the process of moving towards peace and understanding, as well as Kyrgyzstan's recovery. In support of the government program and the proposals of the Joint Economic Assessment and the United Nations Flash Appeal, donors have pledged a total of about $1.1 billion to support vital government expenses and services, social needs and vital investments.

The **Asian Development Bank** invested over $65.2 million in providing emergency assistance to the country.

The **World Bank** provided $70 million for the Emergency Recovery Project to provide financing for high-priority expenditure in emergency recovery and reconstruction, and to support the rehabilitation and repair of energy infrastructure and networks to ensure country-wide energy supplies in the winter period. Moreover, the bank approved additional financing of $10 million for the National Road (Osh–Batken–Isfana) Rehabilitation Project.

The **EBRD** allocated over $6 million for supporting small and medium-sized businesses in Kyrgyzstan.

Investments by the **Islamic Development Bank** came to $18.5 million and were spent on financing projects in transport infrastructure and agriculture, as well as SME support.

Russia

Russia traditionally attracts investors with its broad investment opportunities. Almost all international development banks operating in the region took part in the project for the expansion and modernisation of St. Petersburg's Pulkovo International Airport. The total loan financing package of approximately €716 million will be provided by IFC, EBRD, the EDB, NIB, the Black Sea Trade and Development Bank (BSTDB), Russia's Vneshekonombank, and several commercial banks.

The **EBRD's** investment portfolio in Russia increased by around $2.8 billion in 2010. The bank was active in Russia's telecommunications, financial sector, transport, real estate, natural resources, manufacturing and other fields. Moreover, the Multilateral Carbon Credit Fund (MCCF) closed its second deal in Russia by purchasing carbon credits from Air Liquide Severstal resulting from an energy efficiency project involving a modern Air Separation Unit in Russia's Vologda region.

The **EDB** invested $309 million in Russia's projects in 2010, including the construction of a high-tech complex for the production of polycrystalline silicon, modernisation of OJSC Yenisei Territorial Generating Company (TGC-13), and projects in transport infrastructure and the financial sector.

The **World Bank** approved a $25 million loan for the Financial Education and Financial Literacy Project for the Russian Federation. Moreover, the bank provided a $100 million loan for the Preservation and Promotion of Cultural Heritage Project. The project will also help cultural institutions to strengthen their internal capacity for cultural heritage management. In 2010 the **IFC** launched the implementation of 14 projects in different spheres, including construction and transport. The projects' overall value topped $1.2 billion.

Tajikistan

The **World Bank** Group launched a new Country Partnership Strategy (CPS) for Tajikistan, which provides the framework for the World Bank Group's assistance to Tajikistan for 2010-2013. The main objectives of the new CPS, prepared at a time when Tajikistan is addressing the impacts of the global economic crisis, are to reduce the negative impact of the crisis on the poor and vulnerable and to pave the way for sustainable and inclusive post-crisis growth. The new CPS envisages World Bank Group financing of about $140 million over the next four years through the International Development Association (IDA) and about $62 million to be attracted through trust funds. Key initiatives will include strengthening the business environment and access to finance; boosting agricultural productivity; improving the reliability of electricity and water supply; expanding the country's energy production and export potential; and enhancing human capital through higher-quality education and health services. The World Bank Group will selectively use a variety of instruments to support the priority areas identified in the new CPS. These will include investment operations, budget support and analytical work. The World Bank approved the $24.4 million Fourth Programmatic Development Policy Grant for the

Republic of Tajikistan to help the government mitigate the impact of the global economic slowdown and to help it continue to implement its medium-term reform program.

Also the World Bank approved a $2 million grant as an Additional Financing for the Education Modernisation Project in Tajikistan. The Additional Financing will be complemented by the capacity building and technical assistance activities focused on learning assessment funded by the Russian Education Aid for Development (READ). The World Bank also provided a $10 million grant as additional financing for the Ferghana Valley Water Resource Management Project in Tajikistan. The main objective of the additional financing is to increase the coverage of the drained and irrigated areas in Bobojon Gafurov and Kannibodom districts, strengthen the early warning system of the Kayrakkum Dam, and assess geotechnical risks associated with the dam. The International Development Association provided $3 million for a healthcare project to raise the potential and management efficiency of basic benefit packages and financing of the primary healthcare per capita on the national, regional and local levels. IFC financed a project in food industry.

The **EurAsEC Anti–Crisis Fund** disbursed a $70 million financial credit to Tajikistan to maintain the level of budgetary financing of social sectors (education, health and social protection) as originally legislated in 2010.

The **EBRD** supported small farmers, cotton and edible oil producers in Tajikistan. The total amount of EBRD investments in 2010 topped $22 million, including financing of projects for widening the electronic payment services and improving water supply in North Tajikistan.

The **IsDB** focused its attention on projects in transport infrastructure, energy and agriculture by investing a total of $34 million.

The **EDB** provided financial support of $3 million within the framework of the microfinancing program.

Uzbekistan

Uzbekistan has the most industrialised and energy-intensive economy in Central Asia. It uses four times more energy than the world average to produce one dollar of gross domestic product. This is due to aging and dilapidated energy infrastructure, low technological base and lack of investment. Thus, improving the energy efficiency of industrial enterprises is a key task for Uzbekistan's government.

The **World Bank** approved a $25 million credit to Uzbekistan for the Energy Efficiency Facility for Industrial Enterprises Project (UZEEF). Improving energy efficiency and reducing energy consumption in the production process will improve Uzbek industries' overall competitiveness, free up scarce gas resources for exports and reduce greenhouse gas emissions.

The **ADB** participated in financing the project for the construction of a new power plant to improve energy security and facilitate regional energy trade. The project also aims to increase energy efficiency and save energy through clean power generation. The ADB financing of $340 million will help fund the construction of Central Asia's first 800 MW combined cycle gas turbine (CCGT) power plant. Moreover, the ADB provided a $50 million loan and a $600,000 grant to three Uzbek banks to help them finance micro and small enterprises, with around 25% of microloans to be extended to women.

The **IsDB** will extend a record $167.2 million for the reconstruction and upgrading of the M-39 highway in the Surkhandarya region, the biggest IsDB endeavour in Uzbekistan to date. Moreover, the IsDB will provide $11.7 million in financing for the construction and equipping of 13 secondary schools and the training of 300 teachers in rural areas.

Directions for Further Growth

As specified in the current review, the international development banks play a significant role in the development of the region's economies. However, this work should be continued. The region obviously has a high need for wider investments focused on a sustainable long-term development that will raise the standards and quality of living in the post-soviet states. It is necessary to secure capital inflow and attract strategic investors to the private sector. The region's economies need diversification, improvement of corporate and state governance, the introduction of openness and transparency standards, as well as the implementation of business environment and social responsibility principles. Given Central Asia's particular exposure to the implications of climate change, additional requirements must be set for the environmental impact assessment level. The bulk part of future investments should be directed to basic infrastructural sectors needed for sustainable economic development: energy, transport infrastructure, and municipal and telecommunications infrastructure.

At the same time, it is worth noting that the international development banks are currently the most competent investors in the region, able to provide financing for capital-intensive projects and add knowledge and expertise, consistent with modern requirements.

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- The original typescript should be submitted electronically in A4 size format, with 1.5-spaced typing preferred and a wide margin on the right.
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Khristenko V.B. (2004) Making Headway to Integration, *Russia in global politics,* 2 (March-April). http://eng.globalaffairs.ru/numbers/6/508.html

Mau V., Novikov V. (2002) Otnosheniya ES i Rossii: prostranstvo vybora ili vybor prostranstva? *Voprosy ekonomiki*, 6: 133-143.

Olcott M.B., Aslund A., Garnett S.W. (1999) *Getting It Wrong. Regional Cooperation and the Commonwealth of Independent States*, Washington D.C.: Carnegie Endowment for International Peace.

Schleifer A., Treisman D. (2003) *A Normal Country*. NBER Working Paper 10057.

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- Please use the international system for units of measurement.

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Journal of Eurasian Economic Integration

The Journal of Eurasian Integration is a quarterly academic and analytical journal published in Russian by the Eurasian Development Bank. The members of Editorial Board and Advisory Council are distinguished academicians, practitioners and experts in regional integration. Eurasian Economic Integration brings together academic and analytical articles, reviews of books relating to regional integration, interviews and quarterly chronicles of regional integration. With its focus on economics, the journal is a rich source of material addressing a broad range of issues specific to Eurasian integration. These include integration theory and its relevance to the development context; economic integration (trade, investment, financial institutions); institutional integration; cooperation issues in the post-Soviet space; and international experience of regional integration. The first issue was published in the third quarter of 2008.

Requirements for submissions. Papers should be sent by e-mail to editor@eabr.org for blind review. There are no strict limitations on the length of articles. However, the Editorial Board recommends authors to adhere to 6000-8000 words or 30000-40000 characters. In addition to the main text, authors must a brief author(s)' biography (100-150 words), executive summary (100-150 words) and bibliography. These materials must be attached in a separate file.

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Eurasian Integration Yearbook publishes wide range of articles and other materials in English language on theory and practical aspects of Eurasian integration. The major part of the annual Yearbook consists of English versions of selected articles published in the Journal of Eurasian Economic Integration and other analytical publications of EDB. These are supplemented by integration chronicles for the respective year. The Yearbook improves access of the world community to the best papers on various issues of regional integration published in Russian language. Apart from papers published in the Journal of Eurasian Economic Integration, papers written specifically for the Yearbook are also welcome (submission in English or Russian).

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- no.3. The CIS Common Electricity Market. August 2008. In Russian and English.

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- no.4. The Eurasian Development Bank's investment policy and the environment. February 2009. In Russian and English.
- no.5. The EurAsEC Transport Corridors. March 2009. In Russian and English.
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- no.7. Economic Cooperation in Agricultural Sector of CIS Countries. March 2010. In Russian and English.

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- Development banks' operations and activities in the CIS countries and issues of cooperation.

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EDB Eurasian Integration Yearbook

The EDB Eurasian Integration Yearbook publishes articles and reports addressing wide spectrum of pertinent issues of regional integration, in particular its economic and institutional aspects, the theories of integration, and relevant international experience.

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The Eurasian Development Bank is an international financial institution established to promote economic growth and integration processes in Eurasia. The Bank was founded by the intergovernmental agreement signed in January 2006 by the Russian Federation and the Republic of Kazakhstan. The Bank was founded by the intergovernmental agreement signed in January 2006 by the Russian Federation and the Republic of Kazakhstan. Tajikistan, Belarus and Armenia joined the Bank in 2009–2010. Electric power, water and energy, transportation infrastructure and high-tech and innovative industries are the key areas for the Bank's investment activity.

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