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## **EDB Eurasian Integration Yearbook 2012**

Vinokurov, Evgeny

Eurasian Development Bank

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# EURASIAN INTEGRATION YEARBOOK 2012

Annual publication of the Eurasian Development Bank



# 2022



## Eurasian Integration Yearbook

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. Tajikistan, Belarus, Armenia and Kyrgyzstan joined the Bank in 2009-2011.

Electric power, transportation infrastructure and high-tech and innovative industries are key areas for Bank's financial activity. In line with its charter, the Bank views information and research support for integration in Eurasia as a priority of its analytical work.

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# 2012

## Eurasian Integration Yearbook

Annual publication of the Eurasian Development Bank

**Edited by Evgeny Vinokurov, EDB**

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# List of Abbreviations

ACF – EurAsEC Anti-Crisis Fund  
 ADB – Asian Development Bank  
 ASEAN – Association of Southeast Asian Nations  
 BSTDB – Black Sea Trade and Development Bank  
 CAREC – Central Asia Regional Economic Cooperation Programme  
 CIS – Commonwealth of Independent States  
 CPI – consumer price index  
 CRRF – Collective Rapid Reaction Force  
 CSTO – Collective Security Treaty Organisation  
 CU – Customs Union  
 CU CCT – CU Common Customs Tariff  
 EBRD – European Bank for Reconstruction and Development  
 ECB – European Central Bank  
 EDB – Eurasian Development Bank  
 EDB CIS – Centre for Integration Studies of the Eurasian Development Bank  
 EEC – Eurasian Economic Commission  
 EIB – European Investment Bank  
 EU – European Union  
 EurAsEC – Eurasian Economic Community  
 FEACN – Foreign Economic Activity Commodity Nomenclature  
 FDI – foreign direct investment  
 FTA – free trade area  
 GATT – General Agreement on Tariffs and Trade  
 GDP – gross domestic product  
 GTS – gas transportation system  
 GUAM – Georgia, Ukraine, Azerbaijan and Moldova regional cooperation group  
 HPP – hydropower plant  
 IBRD – International Bank for Reconstruction and Development  
 ICAO – International Civil Aviation Organisation  
 IDA – International Development Association  
 IFC – International Finance Corporation

IEF RAS – Institute of Economic Forecasting at the Russian Academy of Sciences  
 IEF NASU – Institute of Economics and Forecasting at the National Academy of Sciences of Ukraine  
 IMF – International Monetary Fund  
 IPO – initial public offering  
 IPS – integrated power system  
 IsDB – Islamic Development Bank  
 ISO – International Organisation for Standardisation  
 KASE – Kazakhstan Stock Exchange  
 KTZh – Kazakhstan Temir Zholy  
 M&A – mergers & acquisitions  
 MDBs – multilateral development banks  
 MIGA – Multilateral Investment Guarantee Agency  
 MMI CIS – monitoring of mutual investments in CIS countries and Georgia  
 NAFTA – North American Free Trade Agreement  
 NIB – Nordic Investment Bank  
 NPP – nuclear power plant  
 OECD – Organisation for Economic Cooperation and Development  
 OFID – OPEC Fund for International Development  
 OPEC – Organisation of Petroleum Exporting Countries  
 PPP – public private partnership  
 RZD – Russian Railways  
 SCO – Shanghai Cooperation Organisation  
 SES – Single Economic Space  
 SME – small and medium enterprises  
 TNC – transnational corporation  
 TPP – thermal power plant  
 UAC – United Aircraft Corporation  
 UES – Unified Energy System  
 UN – United Nations  
 UN COMTRADE – United Nations Commodity Trade Statistics Database  
 UNCTAD – United Nations Conference on Trade and Development  
 UNDP – United Nations Development Programme  
 UNPRI – United Nations Principles for Responsible Investment  
 WB – World Bank  
 WTO – World Trade Organisation

## FOREWORD

The Eurasian Development Bank is an integration bank; an essential part of its mission is to advance economic integration between its member states. The Bank's projects focus on fostering mutual trade and investments and its portfolio comprises over 50 projects in different economic sectors, including agriculture, metallurgy, energy and transportation.

The EDB's activities in the region, however, are not only limited to financial investments in development and integration. The Bank developed rigorous and vibrant researches into a wide range of integration issues, thereby contributing to integration by its high-level expertise and multifaceted analysis. The EDB Centre for Integration Studies, opened in 2011 with the purpose of undertaking research into regional economic integration, has implemented a number of research projects to date, ranging from corporate integration and the impact of the Customs Union and the Single Economic Space on regional economies to the likelihood of creating common labour market in the area and assessing public attitudes towards Eurasian integration. The Centre's figures on the CU's macroeconomic impact have by now become a standard assessment.

The findings of these research projects along with those of other important analytical studies are presented in the 5<sup>th</sup> edition of the EDB Eurasian Integration Yearbook, which the Bank has published annually since 2008. The series is a compilation of authoritative papers and in-depth studies examining the most important aspects of Eurasian integration. I am happy to confirm the EDB's continued commitment to research on regional integration.

**Igor Finogenov**

Eurasian Development Bank  
Chairman of Executive Board

## DEAR READERS,

2012 has been marked by the intensification of integration trends in the post-Soviet space. The Belarus-Kazakhstan-Russia Customs Union (CU) expanded into the Single Economic Space (SES), bringing into action a set of seventeen agreements ranging from the coordination of macroeconomic and fiscal policies to labour migration, energy and technical regulation. The SES' key goal is to promote four basic economic freedoms – the free movement of goods, capital, services and people. The Eurasian Economic Commission, a supra-national body with extensive powers, has been set up to facilitate efficient operation of SES, with appointed commissioners in charge of each functional dimension of integration.

An efficient Eurasian bloc will facilitate efficient economic cooperation with both developed markets and emerging economies. It will increase competition and promote equal conditions for businesses and investors from different regions. The SES will help to effectively reduce and eventually eliminate the practice of restrictive national rules at all stages of doing business. The SES will also guarantee an upgrade of technical regulations and standards. The transition towards modern standards will ensure their full compliance with WTO standards as well as a high degree of compatibility with EU and ISO standards, which will facilitate technological integration for all manufacturers, including investors from outside of the SES, and across the EU/SES areas. In the mid-term perspective, Eurasian integration will be developing in two directions – the present integration initiatives will be gaining further depth whilst also widening their geography. The manifesting success of the CU and SES can be explained by the clear focus on well-defined, manageable and concrete tasks of integration. Furthermore, the specifics of the post-Soviet integration is its thorough and stable foundation, made up of a multitude of intertwined economic ties, which can be put to good use in the new integration projects. The interconnections of production factors, for example, like those of labour and capital, are showing an impressive dynamics today, which is proving that the intensification of integration trends is in demand.

The Eurasian Development Bank has truly become an important engine of economic integration. With the launch of the EDB Centre for Integration Studies last year, the Bank has significantly expanded its research and policy analysis of regional integration. The Eurasian Economic Commission welcomes this initiative as a very timely and expedient step to advance research in an area that has become extremely important for today's political and economic agenda of the region. The EDB Eurasian Integration Yearbook is there to supply the global expert audience with information and analysis on Eurasian integration.

**Tatyana Valovaya**

Eurasian Economic Commission, Member of the Board,  
Minister for Macroeconomics and Principal Directions of Integration

# The Customs Union and the Single Economic Space: Towards the Eurasian Economic Union

Evgeny  
Vinokurov

**Evgeny Vinokurov** – Ph.D., Director of the EDB Centre for Integration Studies.

The Customs Union of Belarus, Kazakhstan and Russia was established in 2010. It expanded into the Single Economic Space in 2012, based on a comprehensive set of agreements covering subjects from the coordination of macroeconomic and fiscal policies to labour migration, energy and technical regulation. Regional integration will be taken a step further through the planned creation, by 2015, of the Eurasian Economic Union. The Customs Union was the first major systemic integration initiative to make it as far as the implementation stage. Importantly, the Eurasian Economic Commission may also come to represent the first truly supranational institution in the region's 20 years of post-Soviet reintegration attempts.

The primary goal of the SES is to promote the free movement of goods, capital, services and people. It will increase competition and create equal conditions for all businesses and investors, regardless of their country of origin. The SES will reduce and ultimately eliminate the structures of national legislation at every stage of the business transaction and guarantees an overhaul of technical regulations and standards. The adoption of improved standards will ensure that



the SES complies fully with WTO standards and that there is a high degree of compatibility with EU and ISO standards. This will facilitate technological integration between manufacturers, including investors from outside the SES.

The EDB System of Indicators of Eurasian Integration<sup>1</sup> shows that the decline of integration in the post-Soviet space in the 2000s and the general trend of the 1990s have not been reversed. The composite index of integration in the post-Soviet space suggests that integration levels have generally been falling, but that Russia, Kazakhstan and Belarus have in fact become more integrated. This counter-process genuinely stands out. These three economies form an 'integration core' in the post-Soviet space, which, during the first decade of the 21<sup>st</sup> century, has developed from the bottom up, with its roots in enterprises and households. In 2009-2010 the formation of this integration core gained momentum, largely due to the global economic crisis, and culminated in the establishment of the CU.

The development of the CU and the SES is crucial for the success of regional economic cooperation. It encompasses vital processes such as the trade in goods and services, movement of labour, macroeconomic coordination, financial integration, common technical regulations, and regulatory convergence. Applied economic research is, in turn, crucial for a deeper understanding and appropriate management of these complex processes. The Eurasian Integration Yearbook, published for the fifth consecutive year, attempts to move in this direction.

## TWO EURASIAN INTEGRATIONS

Further development of regional integration may include a deep and comprehensive free trade area (DCFTA) between the European Union and the SES. Such a DCFTA would represent a huge step forward by removing barriers to trade in goods and services, improving the management of intellectual property and the mobility of labour and capital. Furthermore, the SES is already taking its first steps towards free trade with its Asian and Pacific partners. Smaller economies (Vietnam, New Zealand, etc.) as well as large economies (South Korea, India, and China) immediately spring to mind. Spilling over the boundaries of the former Soviet Union entails 'another' Eurasian integration, distinct from the post-Soviet one.

As the post-Soviet space forms part of the greater Eurasian 'super-continent', regional integration in Northern and Central Eurasia should be viewed in the context of wider economic and political interconnection. Continent-wide Eurasian integration is gradually becoming a reality. This spreads 'from the

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<sup>1</sup> Eurasian Development Bank (2009) *The System of Indicators of Eurasian Integration*. EDB: Almaty. Available at [www.eabr.org/e/research/centreCIS/projectsandreportsCIS/siei/](http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/siei/)

bottom up', with minimal support from national governments. We think that an important task for the 2010s – both for researchers and practitioners – will be to reconcile both kinds of 'Eurasian integration', the post-Soviet and the continental one. The latter we take to be the qualitative growth of economic links between various sub-regions of the Eurasian continents – Europe, East Asia, South Asia, West Asia, and Northern and Central Eurasia (i.e., the post-Soviet space).

In our view, Eurasian continental integration could become a key driver of development, motivated by the integration of energy trade, non-energy trade and transport, capital and labour flows, tourism, pharmaceuticals trade and epidemiological threats. A key question is whether or not the main continental powers will allow this integration – which represents a catch-up process in the historic worldwide drive for globalisation – to proceed smoothly and efficiently by cooperating in the establishment of transport networks, opening up access to natural and human resources and creating institutions that support collective action in the pursuit of regional benefits and the alleviation of regional disadvantages. Or, conversely, will competition over resources, boundaries and allegiances, or disagreements over values and political systems drive deep wedges between countries and sub-regions across Eurasia, as they had in the past.

Although potentially vital for all countries involved, Eurasian integration has particular significance for Russia and Central Asia. These countries have much to gain from Eurasian integration that is constrained within the boundaries of the post-Soviet area. Therefore, it is valid to argue in favour of open regionalism in Eurasia as an economically optimal component of post-Soviet integration. The 'two Eurasian integrations' should supplement each other.

## REVIEW OF CONTRIBUTIONS

The 20 contributions in this volume are divided into four sections.

The section on the *Customs Union and the Single Economic Space* features papers relating to economic impact, including that of potential enlargement. The first paper presents the results of a large-scale project, which combined the forces of three institutions – the Moscow-based Institute for Economic Forecasting, the Kyiv-based Institute for Economy and Forecasting, and the EDB Centre for Integration Studies. The results of the project provide a coherent and nuanced picture of the long-term economic impact of the CU. It also extrapolates the model to Ukraine and the potential impact of the country's accession to the CU. The paper by Alexander Pavlov analyses the potential impact of Kyrgyzstan's accession to the CU. It is followed by an incisive commentary by Nazik Beishenaly based on the independent research into the same issue. The section includes an important paper by Tatyana Valovaya, a Minister of the Eurasian Economic Commission. Her paper outlines the history and principles

of Eurasian post-Soviet integration. This paper provides comprehensive insight into the general patterns of regional integration in the post-Soviet space and how the extensive experience of the European Union is being carefully rethought by its eastern neighbours.

The section on *The Economics of the Post-Soviet and Eurasian Integration* aims to knit together what we call the 'two Eurasian integrations' – that is, the post-Soviet and continental ones. Evgeny Vinokurov and Alexander Libman summarise the findings of their two monographs, each of which focused on one of these two types of Eurasian integration. Throughout the last two decades, the term 'Eurasia' has been used more and more by scholars and practitioners, but the definition of the term has remained unclear. This lack of clarity is amplified for the concept of Eurasian integration. The authors elaborate on the concept of Eurasia and Eurasian integration, distinguishing between three notions of 'Eurasia' and corresponding views of Eurasian integration, and evaluate their importance in literature and possible research developments. The next paper by Johannes Linn, a well-known and influential proponent of Eurasian integration, delves into the intricacies of Central Asia. Based on the large body of research, Linn elaborates on the opportunities provided by this region, which could well serve as the laboratory of continental integration in Eurasia.

The following three contributions bring us back to the post-Soviet space, covering three complex issues: public finances (Elvira Kurmanalieva and Konstantin Fedorov); mutual investments (Alexey Kuznetsov); and EDB Integration Barometer (by Igor Zadorin). All three papers originate from the projects undertaken by the EDB Centre for Integration Studies. Alexey Kuznetsov's account in particular presents the database on mutual investment in the Commonwealth of Independent States (CIS), which includes around 600 examples.

The section on *Advanced Economic Cooperation in Sectors and Industries* features three sectors: air transportation and electric power (Aigul Absametova); and hydropower and water management in Central Asia (Vladimir Yasinskiy, Alexander Mironenkov and Tulegen Sarsembekov). Based on our assuredness that robust integration is formed primarily 'from the bottom up' by means of substantial cooperation, the EDB continues to publish a series of reports on cooperation in particular sectors and industries throughout the post-Soviet space.

The fourth section, *Data and Reviews*, reflects the structure of previous Yearbooks representing a very substantial source of information for researchers and students. It includes a chronicle of regional integration by Natalia Maqsimchook, a structured digest on the main events in post-Soviet integration in 2011. The Key Macroeconomic Indicators in CIS Countries complement the Chronicle. Ella Baibikova's overview of international and regional development bank activity in the CIS rounds off this section. Multilateral development banks

represent both the objects of integration and its subjects, since they proactively shape economic interaction between countries, for example, by investing in crucial cross-border infrastructure. Therefore, this overview is highly relevant for all research on regional integration.

Overall, the Yearbook is an attempt to provide a dynamic overview of integration processes in the post-Soviet 'Eurasian' space and of the challenges to which the Northern and Central Eurasian states will have to provide adequate responses. I genuinely hope that the EDB's annual Eurasian Integration Yearbook will become a reliable companion to those studying regional integration. Once again I am pleased to direct readers to the EDB website ([www.eabr.org](http://www.eabr.org)), where this volume, previous Yearbooks, the Journal of Eurasian Economic Integration (in Russian) and a number of reports and stand-alone papers relevant to regional integration are available to download free of charge.

# The Economic Effects of the Creation of the Single Economic Space and Potential Accession of Ukraine<sup>1</sup>

Viktor Ivanter  
Valery Geets  
Vladimir Yasinskiy  
Alexander Shirov  
Andrey Anisimov

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<sup>1</sup> This article has been prepared based on a research conducted from Russia – by Prof. V. Ivanter, RAS member, M. Uzyakov, D. Kuvalin, I. Frolov, A. Shirov, A. Moiseyev, M. Gusev, A. Yantovskiy, and V. Potapenko, junior research fellow; from Ukraine – by Prof. V. Geets, NASU member, L. Shinkaruk, T. Shinkorenko, and Y. Gerasimova; from the Eurasian Development Bank – E. Vinokurov and A. Anisimov.

## INTRODUCTION

The collapse of the Soviet Union led to the severing of a multitude of economic ties, which exacerbated the crisis of the 1990s. In recent years, the desire to recover from these losses and utilise the surviving industrial and technological potential has driven integration processes in the post-Soviet area – this time on the basis of new, market-based principles.

Reconstructive integration processes can play an important role in adding impetus to the advancement of the largest post-Soviet countries. On the one hand, economic *reintegration* will produce standard *synergistic effects* such as reduced transaction costs in bilateral and multilateral cooperation, improved terms of trade and investment exchange, gains from the transnational division of labour, and the creation of new market opportunities. On the other hand, the relative uniformity of the technological arena and the common linguistic and cultural environment allow the mechanisms of interaction between post-Soviet countries to be greatly simplified.

The economic growth in almost all post-Soviet countries made it possible to develop successful interaction and form the necessary resources that can be used to speed up integration.

In recent years, tangible prerequisites have emerged for the formation and rapid development of an economic union between the region's countries. In 2010, the Customs Union between Belarus, Kazakhstan and Russia began to operate. Seventeen agreements that form the basis of the Single Economic Space are entering into effect in 2012. In 2015, the SES states intend to establish the Eurasian Economic Union, which other post-Soviet countries can join.

The study of fundamental conditions and practical effects of Eurasian integration are an important research and expert objective addressed by the Comprehensive Assessment of the Macroeconomic Effects of Various Forms of Deep Economic Integration of Ukraine and the Member States of the Customs Union and the Single Economic Space<sup>2</sup>. This survey continued the three-year cooperation between the Eurasian Development Bank, the Institute of Economic Forecasting at the Russian Academy of Sciences (IEF RAS), and the Institute of Economics and Forecasting at the National Academy of Sciences of Ukraine (IEF NASU)<sup>3</sup>.

This survey is the most comprehensive analysis of the effects of deep economic integration between the economies of Russia, Ukraine, Kazakhstan and Belarus prepared in the past twenty years.

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<sup>2</sup> Full version of the report is available at: <http://www.eabr.org/ir/research/analytics/centre/projects/ukraine/>. Please refer to this link for literature and complete methodology of the project.

<sup>3</sup> Scientific and Technological Interaction between Russia and Ukraine: Forecasting Opportunities and Mechanisms for Their Implementation; Assessment of Macroeconomic Effects of Ukraine Joining the Customs Union and the Single Economic Space within the Framework of EurAsEC.

## METHODOLOGY

The issues relating to the creation of economic unions between nations are critical elements of long-term economic policies that cannot be implemented without a comprehensive analysis of the consequences of the decisions under consideration. At the same time, there is a palpable lack of the type of work that would provide quantitative assessments of the possible macroeconomic and sectoral effects of the expansion of integration processes in the post-Soviet area. In accordance with this, research was carried out to test and produce a numerical estimate for various hypotheses of the possible integration scenarios between the Customs Union countries and Ukraine.

A quantitative assessment of integration effects of the economic unions of various types and scales is associated with significant theoretical and technical difficulties. Even with respect to European integration, although it has a history of over fifty years, the economic science still lacks uniform approaches to assessing integration effects of the creation and functioning of the European Community. In addition, integration processes in the post-Soviet area have their own significant peculiarities.

The key objectives of the research were to determine the status quo and outlooks for the advancement of integration ties between Ukraine, Russia and Russia's partners within the Customs Union and the Single Economic Space; to develop methodological tools to assist in the selection of the efficient forms and areas for the development of integration processes; and to assess, in a sound and comprehensive manner, the economic effects of Ukraine joining the SES, for Ukraine itself and for Russia, Kazakhstan and Belarus.

Methodologically, the assessment of integration effects was carried out using a model analytical and forecasting set, which includes intersectoral macroeconomic models for Russia, Ukraine, Belarus and Kazakhstan, and a trade model which forms export and import flows in the countries under consideration in their mutual trade and their trade with other countries.

Before developing the model analytical and forecasting set a comparative analysis of the existing approaches to the quantitative assessment of integration effects was carried out. These approaches used in the world practice include computable general equilibrium models, gravity models, dynamic input-output models for intersectoral production, and multiple regression models.

The statistics used in the model set are official data from national statistics agencies and international institutions.

The input and output tables of the countries were adjusted to a single classification of sectors based on the 45<sup>th</sup> sectoral structure of the input and output table of the Russian Federation. A correspondence matrix was prepared for each country, with coefficients showing which sectors in the initial input

and output table are included in a sector of the baseline table or are distributed between several sectors in a certain proportion.

The coefficients for the correspondence matrix (each country had its own matrix) were calculated using the data provided in national accounts, which present the sectoral structure of the economies in the most detailed manner.

In addition, data on foreign trade between the SES countries and Ukraine have been prepared and aligned and the process of the formation of scenario conditions for the forecast has been modelled.

### SCENARIO APPROACH

Integration effects can be provisionally divided into instant and long-term effects. The first group is connected primarily to the reaction of an economy to a reduction or abolishment of customs barriers. As a rule, instant effects are a change in the volume of foreign trade flows. However, their impact on the economic dynamics discontinues almost completely in a short period of time. Instant integration effects are relatively easier to assess because they are directly connected to the historical elasticity of foreign trade flows against changes in

**Table 1.1.**  
Integration scenarios  
considered

	Scenario	Impact	Objective
1	Baseline 0	Contains baseline inertial macroeconomic scenarios for Russia, Kazakhstan, Belarus, and Ukraine. Does not provide for the creation of the SES or intensification of integration processes in the post-Soviet area	Formation of the baseline characteristics of economic development for the countries under analysis; creation of a basis for the analysis of the SES effects on Russia, Kazakhstan and Belarus
2	Baseline 1	Provides for the creation of the SES of Russia, Kazakhstan, and Belarus in 2012, the removal of all mutual trade barriers, and technological convergence between the countries in the forecast period	Formation of the effects of SES creation by three countries: Russia, Kazakhstan and Belarus
3	CIS FTA	Ukraine joins the CIS FTA on the terms of the agreement signed on October 18, 2011 in St. Petersburg (with exceptions)	Assessment of the impact of the CIS FTA, in its current form, on the economic development of the countries under analysis
4	CIS FTA + EU FTA for Ukraine	Ukraine joins the European Union FTA; CIS FTA countries take foreign trade protective measures envisaged by the agreement dated October 18, 2011	Assessment of the impact of the creation of the EU FTA on the Ukrainian economy with a simultaneous deterioration of trade and economic relationships with the SES countries
5	SES + Ukraine	Ukraine joins the framework SES Agreements	Assessment of the impact of the complete removal of foreign trade barriers between the countries, the expansion of cooperation, and technological convergence on the Ukrainian economy and the SES countries
6	SES + Ukraine (exchange rate unification)	Ukraine joins the framework SES agreements; the countries unify the currency system within the SES and implement a single currency policy	Assessment of the impact of exchange rate unification, within the framework of deeper integration, on the Ukrainian economy and the SES countries



customs tariffs. Long-term integration effects are connected to dynamic and structural changes in economies caused by changes in the efficiency parameters, the creation of cooperation ties, and the expansion of markets.

To produce a quantitative assessment of integration effects, several scenarios need to be considered. An analysis and comparison of these calculations make it possible to formulate conclusions on the significance of integration processes for economies.

The possible scenarios of integration in the post-Soviet area were calculated using a set of intersectoral macroeconomic models of Russia, Kazakhstan, Belarus and Ukraine developed in the course of research.

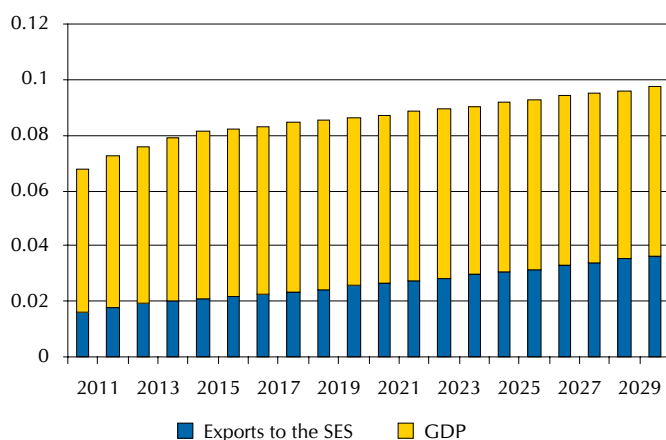
The scenarios that have been considered are presented in *Table 1.1*.

The calculations make it possible to produce an incremental assessment of the effects of integration in the post-Soviet area for a number of current scenarios that factor in trade (instant) effects and technological convergence (long-term effects).

### SES-3

The calculations suggest that the creation of the Single Economic Space between Russia, Kazakhstan and Belarus would have a positive effect on the development of the countries involved. Given the existing economic structure, the primary directions of foreign trade relationships, and the scale of the economies, it is expected that the greatest effects will be observed in Belarus.

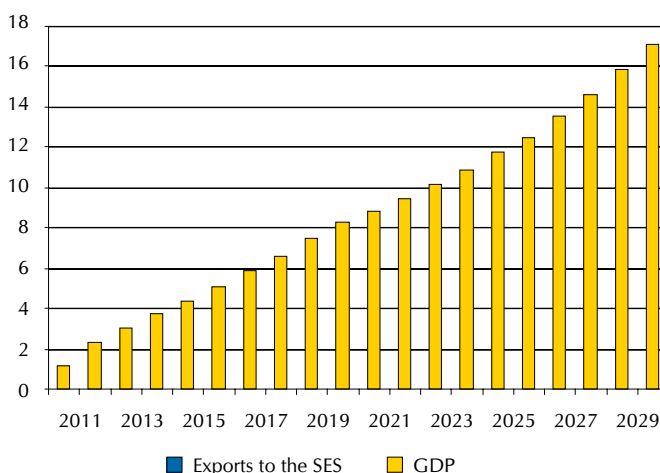
By the end of the forecast period, exports to the SES countries are expected to account for up to 35% of Belarusian GDP. By 2030, the GDP gain in this option is forecasted to outrun the baseline by up to 15%. Therefore, the calculations show that, in the long run, the success of integration processes in the post-



**Figure 1.1.**  
Effects of SES  
creation on Belarus  
a) Belarusian GDP  
and exports to the  
SES (\$ trillion)

**Figure 1.1.**  
Effects of SES  
creation on Belarus

b) Additional  
increase in Belarusian  
GDP under the  
SES-formation option  
(2010, \$ billion)

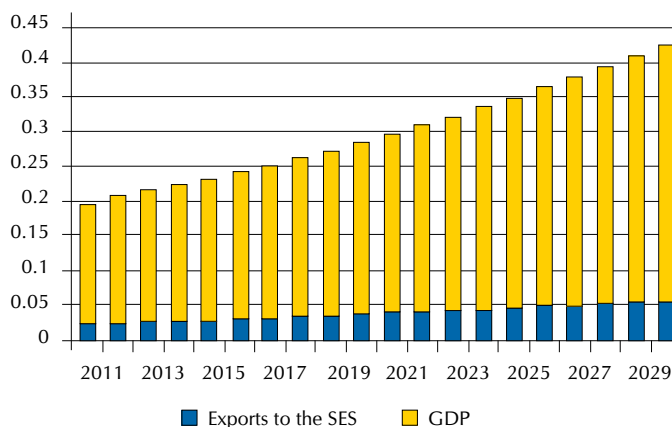


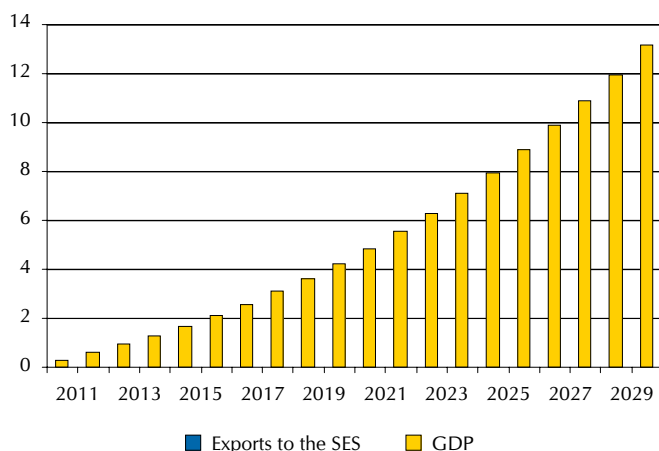
Soviet area will be of vital importance to the advancement of the Belarusian economy. The share of mechanical engineering and food processing in the country's industrial structure is expected to grow.

Kazakhstan's economy remains dependent, to a significant extent, on the dynamics of hydrocarbon production. This situation is largely associated with the fact that Kazakhstan continues to enjoy relatively high potential for the expansion of oil and gas production. Though increasing, exports to the SES countries remain at a relatively low level compared to GDP. At the same time, due to technological convergence and a reduction in the energy and material intensity of production, integration processes allow reaching an additional GDP of 4% compared to the baseline scenario by the end of the forecast period.

**Figure 1.2.**  
Effects of SES  
creation on  
Kazakhstan

a) Kazakhstan's GDP  
and exports to the  
SES, in constant 2010  
prices (\$ trillion)



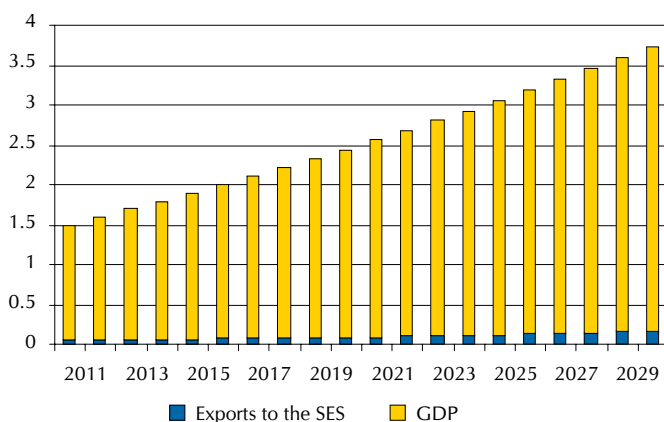


**Figure 1.2.**  
Effects of SES  
creation  
on Kazakhstan

b) Additional  
increase in  
Kazakhstan's GDP  
under the  
SES-formation option  
(2010, \$ billion)

The share of mining sectors and metallurgy in the Kazakh economy will gradually decline. A rapid growth in the service sector, mechanical engineering, transportation and communications will result in the growth of their respective shares in gross output.

As the scale of the Russian economy cannot be compared with those of other SES countries, integration processes in the post-Soviet area are not expected to produce a determining impact on the dynamics of Russian GDP. In addition, the gradual devaluation of the Belarusian rouble, against the backdrop of increasing energy prices, will have an additional adverse effect on the trade and economic relationships within the SES (first and foremost, on the trade between Russia and Belarus).

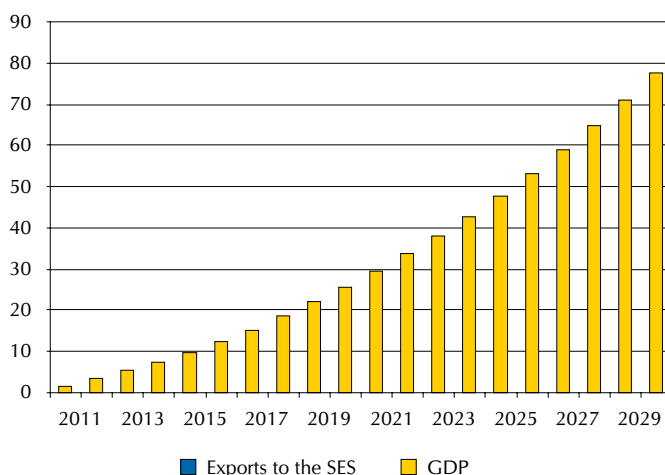


**Figure 1.3.**  
Effects of SES  
creation on Russia

a) Russian GDP and  
exports to the SES, in  
constant 2010 prices  
(\$ trillion)

**Figure 1.3.**  
Effects of SES  
creation on Russia

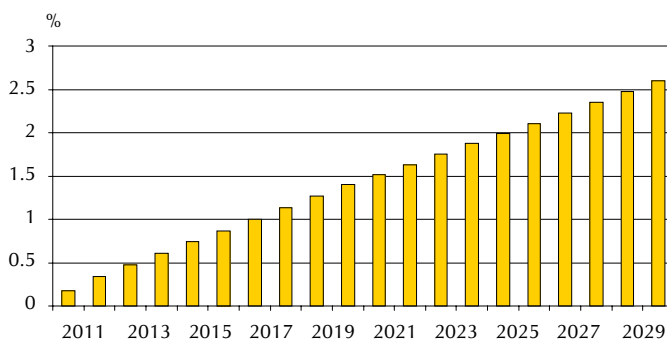
b) Additional  
increase in Russian  
GDP under the  
SES-formation option  
(2010, \$ billion)



The development of integration ties will allow Russia to reap an additional annual gain of more than 2% of the baseline GDP by the end of the forecast period.

The three countries' cumulative gain from the formation of the SES, compared to the non-integration scenario, is shown in *Figure 1.4*. As for the aggregate GDP of the SES countries, the difference between the options is expected to exceed 2.5% by 2030. In 2030, the GDP gain over the baseline option is expected to reach \$75 billion for Russia (in 2010 prices), \$13 billion for Kazakhstan, and \$14 billion for Belarus. From 2011 to 2030, the cumulative effect of the development of integration ties can be estimated at \$632 billion (in 2010 prices) for Russia, \$106.6 billion for Kazakhstan, and \$170 billion for Belarus.

**Figure 1.4.**  
Integral effect of SES  
creation on Russia,  
Kazakhstan  
and Belarus  
(additional increase  
in the three  
countries' aggregate  
GDP over the  
baseline scenario,  
% of GDP)



## UKRAINE, SES-3 AND FTA, SES-4

The baseline scenario for the development of the Ukrainian economy assumes that the key trends of the economic development observed in recent years will continue.

The main problem, which Ukraine is expected to encounter in the baseline scenario, is that, given the growing energy prices<sup>4</sup>, the necessary level of competitiveness of producers can only be maintained if energy intensity is reduced in an accelerated manner. A radical reduction in energy intensity requires, in turn, large investments. Revenue losses against the backdrop of rising costs maintain the relatively low fixed capital accumulation rates. At the same time, production growth is restricted because of the gradual retirement of "old", idle capital. Therefore, the economy faces an acute problem of limited capital. Nevertheless, the remaining potential to achieve growth using ageing facilities enables the Ukrainian economy to demonstrate higher economic growth than Belarus, which is experiencing an acute deficit of fixed capital.

	2011-2015	2016-2020	2021-2025	2026-2030
Household consumption	6.1	5	4.3	3.6
Government consumption	2.7	2.4	2	1.7
Investments in fixed capital	11	8.5	7.2	5.1
Export	4.1	4.1	4.2	4.3
Import	8.4	7	5.7	4.3
GDP	4.4	3.8	3.9	3.6

**Table 1.2.**  
Average annual  
growth rates of  
Ukrainian GDP  
and the main  
components of the  
end demand  
(in constant prices,%)

Source: Calculations  
by IEF RAS and IEF  
NASU

It should be noted that while the lack of significant changes to the structure of the economy causes a slowdown in economic growth, it is impossible to accelerate the growth in output in exporting sectors. Ukrainian GDP in the baseline scenario is expected to drop in the long term from 4.4% in 2010-2015 to 3.6% in 2025-2030.

As (in the scenario under consideration) Ukraine joins neither the European Union Free Trade Area nor the Single Economic Space, slower growth in exports is expected to have a significant effect on its economy as a whole.

By 2030, the production of electric power is forecasted to increase by 30% to 276 billion kWh. Gas imports are forecasted to grow insignificantly to 43 billion m<sup>3</sup>, 116% of 2010. This will be possible if gas is substituted by

<sup>4</sup> A "window of opportunity" associated with the extension of various energy price discounts to Ukraine will unavoidably close following Russia's transition to the principle of equal return on natural gas supplies to the domestic and foreign markets (in this scenario, taking place in 2015).

coal in Ukraine's energy balance, the energy intensity of production is reduced and domestic production grows to 30 billion m<sup>3</sup>. Oil imports are forecasted to increase by 50% on 2010 to 23 million tonnes (see Table 1.3). The country's higher dependence on energy imports is expected to boost growth in capital investments aimed at the modernisation of production facilities and at reducing energy intensity.

	2010	2015	2020	2025	2030
<b>Oil (million tonnes)</b>					
Production	4	5	5	5	5
Import	8	9	9	10	10
Share of imports in domestic consumption	64.7%	66.3%	65.5%	67.6%	67.9%
<b>Gas (billion m<sup>3</sup>)</b>					
Production	20	26	28	29	30
Import	37	37	38	39	43
Share of imports in domestic consumption	65.2%	59.2%	57.3%	57.4%	58.9%
<b>Coal and peat (million tonnes)</b>					
Production	56	62	68	75	82
Import	12	15	18	20	21
Share of imports in domestic consumption	17.8%	19.3%	21%	21.4%	20.7%
<b>Electric power (billion kWh)</b>					
Production	193	220	245	264	276
Import	2	2	2	2	2
Share of imports in domestic consumption	1.1%	1%	0.9%	0.8%	0.8%

**Table 1.3.**  
**Production and**  
**import of energy**  
**resources in Ukraine**  
(baseline scenario)

Source: Calculations  
by IEF RAS and IEF  
NASU

Traditional exporting industries continue to account for a high share in the Ukrainian economy. The baseline scenario is premised on rather high rates of agricultural growth (up to 4–5% a year), which is expected to make agriculture to account for approximately 7.4% of the Ukrainian gross output by the end of the forecast period. The shares of metallurgy and chemical production also remain high.

To assess the impact of intercountry trade on economic development, estimates were generated for a number of scenarios that differ in terms they envision for Ukrainian integration with the SES countries.

The first scenario envisions Ukraine joining the CIS Free Trade Area (CIS FTA) in 2012, with exceptions (preservation of trade barriers with respect to agricultural products, the fuel and energy sector and metallurgy). According to estimates, this course of events is not expected to have a significant effect on the economies of Russia and Kazakhstan, since the bulk of trade between the

	2010	2015	2020	2025	2030
Agriculture	8.1	8.1	7.8	7.6	7.4
Mining	5.8	5.4	5	4.7	4.5
Food processing (including beverages and tobacco)	9.5	9.9	10.1	10.2	10.2
Textiles and garment manufacturing (including leather manufacturing)	1.1	1.1	1.1	1.1	1.2
Forestry, timber and pulp-and-paper	1.6	1.7	1.8	1.8	1.9
Coke and petroleum products	4.2	2.8	1.7	1	0.5
Chemical production	4.4	4.5	4.7	4.8	5
Production of other non-metal mineral products	1.7	1.9	2.1	2.3	2.4
Metallurgy	9.2	8.7	8.5	8.3	8.2
Mechanical engineering	5.9	6.5	6.9	7.3	7.6
Electric power	4.9	4.5	4.2	3.9	3.7
Construction	3.5	4.6	5.7	6.6	7
Transport and communications	9	9.1	9.2	9.2	9.4
Commerce	10.5	10.7	10.7	10.8	10.8
Services	20.6	20.6	20.5	20.4	20.3
Total	100%	100%	100%	100%	100%

**Table 1.4.**  
Sectoral composition  
of the Ukrainian  
economy in constant  
prices  
(% of gross output)

Source: Calculations  
by IEF RAS and IEF  
NASU

Russia	2015	2020	2025	2030
Export	0.01	0.01	0.01	0.01
Import	0	0	0	0.01
GDP	0	0	0	0
Kazakhstan	2015	2020	2025	2030
Export	0	0	0.01	0.01
Import	0	0	0.02	0.02
GDP	0	0	0	0
Belarus	2015	2020	2025	2030
Export	0.04	0.04	0.04	0.04
Import	0	0	0	0
GDP	0.02	0.02	0.02	0.02
Ukraine	2015	2020	2025	2030
Export	2.38	2.07	1.77	1.51
Import	0	0	0.03	0.05
GDP	0.65	0.56	0.48	0.4

**Table 1.5.**  
Change in key  
macroeconomic  
indicators compared  
to the baseline  
option  
(scenario envisioning  
Ukraine joining the  
CIS FTA,  
with exceptions;  
% of baseline  
volumetric indicators)

Source: Calculations  
by IEF RAS

two countries and Ukraine is in the sectors where the levels of trade barriers remain virtually constant. Belarus' exports and its GDP are expected to grow insignificantly. The most significant gain is forecasted for Ukraine's production, with GDP outpacing the baseline option by an average of 0.5%.

Thus, an unequivocal conclusion is that if Ukraine joins the CIS FTA with exceptions across a number of key sectors this is not expected to have a significant effect on trade and economic relationships in the post-Soviet area. In essence, this option could be deemed the preservation of its status quo with an insignificant positive effect from lifting certain barriers to trade with the CIS countries.

**Table 1.6.**  
**Change in key**  
**macroeconomic**  
**indicators compared**  
**to the baseline**  
**option**  
(scenario envisioning  
Ukraine joining the  
SES; only effects of  
improvements in  
trade with the SES  
countries;  
% of baseline  
volumetric indicators)  
*Source:* Calculations  
by IEF RAS

Russia	2015	2020	2025	2030
Export	0.02	0.04	0.05	0.05
Import	0	0	0	0.01
GDP	0	0.01	0.01	0.01
Kazakhstan	2015	2020	2025	2030
Export	0.02	0.03	0.04	0.05
Import	0.03	0.02	0.04	0.03
GDP	0	0	0.01	0.01
Belarus	2015	2020	2025	2030
Export	0.05	0.04	0.04	0.04
Import	0	0.06	0.06	0.06
GDP	0.02	0.02	0.02	0.02
Ukraine	2015	2020	2025	2030
Export	4.15	3.66	3.14	2.68
Import	0.16	0.16	0.2	0.26
GDP	1.15	0.99	0.85	0.73

In the scenario that envisions Ukraine joining the Single Economic Space without exceptions, the GDP gains for Russia and Kazakhstan are expected to be more appreciable than those under the scenario envisioning the creation of the CIS FTA. In this scenario, Belarusian GDP is expected to remain almost unchanged compared to the scenario envisioning Ukraine's partial joining the SES. For Ukraine itself, the impact on GDP is expected to increase by approximately 50% compared to the previous scenario because of price reductions, lower production costs and increased exports of metallurgical and agricultural products (see Table 1.6).

Another option was considered as a scenario in which Ukraine, instead of joining the Single Economic Space, creates a free trade area with the European



Union. This assumes the reciprocal lifting of customs duties between Ukraine and the EU countries. At the same time, the SES countries are expected to establish customs duties for Ukraine at the levels that are used in trade with European countries. Ukrainian exports to the EU are forecasted to grow by 10% and imports from the EU by 15%.

The trade turnover between the SES countries and Ukraine is forecasted to decrease by approximately 2.5%. Compared to the baseline scenario, this option forecasts lower economic growth for Russia, Kazakhstan and Belarus, triggered by a decline in exports to Ukraine. Ukrainian GDP is also expected to be lower than in the baseline scenario because of a reduction in exports to the SES countries and a growth in imports from the EU, which is expected to exceed the increases in exports to the EU (see Table 1.7).

The main adverse effects on the Ukrainian economy are expected to be caused by:

- a reduction in the aggregate exports of mechanical engineering products;
- the impossibility, because of limited industrial capacity, to accelerate growth in production and in the export of metallurgical, chemical and agricultural products;
- continued dependence on the importation of energy commodities from the SES countries, in a situation characterised by the low price elasticity of consumption; in other words, expenditures of the Ukrainian economy on energy resources are expected to grow significantly.

Russia	2015	2020	2025	2030
Export	0	0	0	0
Import	0	0	0	0
GDP	0	0	0	0
Kazakhstan	2015	2020	2025	2030
Export	0	0	0	0
Import	-0.02	-0.01	-0.02	-0.01
GDP	0	0	0	0
Belarus	2015	2020	2025	2030
Export	0	0	0	0
Import	0	-0.03	-0.03	-0.03
GDP	0	0	0	0
Ukraine	2015	2020	2025	2030
Export	-0.19	-0.08	0.09	0.27
Import	4.22	4.03	3.83	3.54
GDP	-1.28	-1.22	-1.03	-0.94

**Table 1.7.**  
Change in key  
macroeconomic  
indicators compared  
to the baseline  
option  
(scenario envisioning  
Ukraine's joining the  
EU FTA;  
% of baseline  
volumetric indicators)

Source: Calculations  
by IEF RAS

The formation of the Single Economic Space means not only the expansion of intercountry trade, but also deeper industrial cooperation between the enterprises of the countries involved. In addition, the lifting of customs barriers is expected to encourage competition among post-Soviet enterprises that are roughly equivalent in terms of their capacity and potential. All this will stimulate technological convergence between the economies, which will lead, inter alia, to an equalisation of the indicators of energy and material intensity and to the attainment of closer productivity in terms of the utilisation of primary resources. This scenario assumes that the energy and material intensity of the Ukrainian economy will decline at faster rates, levelling off at the standard of the currently more advanced Russian economy. This will cause a reduction in energy consumption and, therefore, lower dependency on energy imports. In addition, lower production costs are expected to enhance opportunities for reducing prices for the purposes of stimulating demand and higher production. The same factor conditions the additional growth in exports.

**Table 1.8.**  
Change in key  
macroeconomic  
indicators compared  
to the baseline  
option  
(scenario envisioning  
Ukraine's joining  
the SES and  
technological  
convergence;  
% of baseline  
volumetric indicators)

Russia	2015	2020	2025	2030
Export	0.03	0.1	0.1	0.1
Import	0	0	0	0.01
GDP	0	0.01	0.01	0.01
Kazakhstan	2015	2020	2025	2030
Export	0.03	0.05	0.07	0.08
Import	0.03	0.02	0.04	0.03
GDP	0	0.01	0.01	0.01
Belarus	2015	2020	2025	2030
Export	0.15	0.34	0.39	0.41
Import	0	0.06	0.06	0.06
GDP	0.06	0.15	0.18	0.2
Ukraine	2015	2020	2025	2030
Export	4.35	4.35	3.73	3.09
Import	-2.19	-5.7	-5.41	-5.28
GDP	2.81	5.94	6.65	6.57

Source: Calculations  
by IEF RAS

In this scenario, the Ukrainian economy is expected to see the greatest effects, as the impact of technological convergence within the SES was already factored in the baseline scenario envisioning the unification of Russia, Belarus and Kazakhstan.

The formation of a unified currency system – or maintaining constant exchange rates for the SES national currencies – could become another element of the Single Economic Space. On the one hand, this would minimise currency

risks of the member states in mutual trade. On the other hand, advantages in bilateral trade will become impossible if a national currency devaluates. At first glance, currency integration seems less advantageous to the net importers of energy resources who cannot offset the trade balance deficit with changes in exchange rates. Thus, it is important to understand whether the effects of the lifting of customs duties and enhanced industrial cooperation will offset the losses associated with the need to use a unified currency system. The estimates generated for this scenario, which encompasses all of the aforementioned factors, indicate that the Ukrainian economy will preserve its gain, though lower compared to the baseline scenario. Given that by 2030 the positive impact of these effects on Belarusian GDP is expected to reach approximately 6% of the baseline GDP, it can be asserted that, in the long term, joining the Single Economic Space with the unification of the currency system will yield a greater gain than that offered by the scenario envisioning the independent setting of exchange rates.

These forecasts reflect the existing integration risks associated with the formation of a single currency and financial system in the post-Soviet area (see Table 1.9).

Russia	2010	2015	2020	2025	2030
Export	0	0.03	0.18	0.98	1.45
Import	0	-0.25	-0.86	-1.48	-2.11
GDP	0	0.02	0.11	0.29	0.41
Kazakhstan	2010	2015	2020	2025	2030
Export	0	0.1	0.27	0.78	1.52
Import	0	-0.37	-1.29	-2.14	-2.92
GDP	0	0.02	0.04	0.18	0.46
Belarus	2010	2015	2020	2025	2030
Export	0	0.13	0.16	-0.08	-0.32
Import	0	0.62	2.29	3.92	7.7
GDP	0	0.03	-0.14	-0.63	-0.74
Ukraine	2010	2015	2020	2025	2030
Export	0.05	2.51	1.56	-1.35	-3.4
Import	0	-1.49	-3.44	-1.26	0.79
GDP	-0.05	2.56	5.78	3.87	1.98

**Table 1.9.**  
Change in key  
macroeconomic  
indicators compared  
to the baseline  
option  
(scenario envisioning  
Ukraine's joining the  
SES with a unified  
currency system  
and technological  
convergence;  
% of baseline  
volumetric indicators)

Source: Calculations  
by IEF RAS

In addition to the quantitative estimate of the overall macroeconomic effects of different integration scenarios in the post-Soviet area it is important to assess possible changes in sectors.

As regards mutual trade in energy commodities Kazakhstan and Russia will clearly remain net exporters in the foreseeable future and Ukraine and Belarus net importers.

In the context of the existing trade and economic relationships it appears that integration will not have a significant effect on trade in primary commodities. The distribution of product flows from these sectors in trade within the SES and between the SES and third countries will depend on demand. It should be assumed that, in the foreseeable future, the production capacities in the primary sectors will continue to significantly exceed domestic demand in post-Soviet countries. This will keep sectors such as metallurgy, chemical production, and fuel and energy export-oriented.

A more complex and pressing task is to provide scenarios for mutual trade in high value-added products, primarily mechanical engineering products.

At present, 70-90% of all mechanical engineering products are imported to the SES countries and Ukraine from other countries. In 2010, Russia imported 92% of all of its mechanical engineering products from third countries, Ukraine 83%, Belarus 75%, and Kazakhstan 72%.

The high share of third countries in equipment imports by the SES countries and Ukraine is explained primarily by the gap in technological development and efficiency of their mechanical engineering sectors.

In terms of energy intensity of GDP, Russia lags significantly behind Europe. In 2010, Russia's energy expenditures per \$1 of GDP (in constant 2005 prices recalculated to reflect purchasing power parity) were almost 300% higher than those of European OECD countries. Importantly, these are the countries that are the main suppliers of mechanical engineering products to the SES countries and Ukraine.

**Table 1.10.**  
Assessment of the  
gap in economic  
efficiency and  
scientific and  
technological  
development  
compared to the  
OECD countries  
(Europe, times)

Source: EIA,  
calculations by IEF  
RAS

	2010	2020	2030
Russia	3.7	2.7	2.5
Kazakhstan	4.3	2.9	2.5
Belarus	4.9	3.2	2.5
Ukraine	5.4	3	2.5

The forecasts of the US Department of Energy<sup>5</sup> and IEF RAS for the productivity of primary resources in the SES countries and Ukraine make it possible to assess their technological gap compared to European OECD countries (see Table 1.10).

<sup>5</sup> <http://www.eia.gov>

In assessing the possible development of trade in mechanical engineering products it can be assumed that mutual trade in these goods between the SES countries and Ukraine has potential to replace imports from third countries to the extent to which the scientific and technological gap can be bridged. In other words, bridging this gap would mean that the SES countries and Ukraine will be able to reduce the share of imports of mechanical engineering products from third countries.

Machinery and equipment production	2010	2020	2030
Share in Ukraine's total output			
Share in Ukraine's exports	6.33	11.31	14.84
Share in Ukraine's exports to the SES	8.12	14.07	18.31
Share of Ukraine's imports in the total sectoral imports (Russia)	3.78	4.97	6.55
Share of imports from Russia in the total sectoral imports (Ukraine)	11.7	11.03	10.53
<b>Shipbuilding</b>			
Share in Ukraine's total output	0.35	0.48	0.61
Share in Ukraine's exports	0.89	1.23	1.51
Share in Ukraine's exports to the SES	0.44	0.89	1.25
Share of Ukraine's imports in the total imports	2.78	4.46	6.4
Share of imports from Russia in the total sectoral imports (Ukraine)	0.71	0.46	0.32
<b>Aircraft manufacturing and space technology</b>			
Share in Ukraine's total output	0.27	0.71	1.1
Share in Ukraine's exports	0.7	2.5	3.8
Share in Ukraine's exports to the SES	2.58	4.69	6.27
Share of Ukraine's imports in the total sectoral imports (Russia)	2.4	3.5	4.7
Share of imports from Russia in the total sectoral imports (Ukraine)	4.15	3.91	3.74

**Table 1.11.**  
Assessment of  
integration effects  
at the sectoral level<sup>6</sup>  
(%)

Source: Calculations  
by IEF RAS

If the technological gap between the SES countries and Ukraine and third countries is bridged, the share of mechanical engineering imports from the SES countries and Ukraine in Russia's aggregate mechanical engineering imports is expected to grow from 8.3% in 2010 to 17.1% in 2030, in Kazakhstan from 28.3% to 46.6%, in Belarus from 24.7% to 39.1%, and in Ukraine from 16.9% to 26.4%. As for trade with Ukraine, sectoral agreements entered into within the framework of its bilateral relationships with Russia or in the process of the country's joining the SES can focus on the sectors that have potential for the production of competitive products in post-Soviet markets. These sectors include aircraft manufacturing, shipbuilding, power engineering, and the production of conventional weapons.

<sup>6</sup> Structural indicators are calculated in constant prices.

It should be noted that the positive trade and economic relationships between Russia and Ukraine would provide potential for a significant intensification of interaction in developing mechanical engineering. For example, the supply of Ukrainian aircraft engines will remain vital for Russian helicopter manufacturers at least through 2017-2018. The available alternative – the construction of factories in Russia – involves high financial and technological risks.

In the area of aircraft manufacturing, the Antonov Design Centre has engineering potential and competencies that Russian manufacturers lack. Moreover, the massive production of aircraft designed in Ukraine is currently impossible without Russian parts and assembly sites.

In addition, a great deal of the defence and dual-purpose equipment that is currently in use in the SES countries features Ukrainian-made parts. The servicing of this equipment will also contribute to the on-going cooperation in the mechanical engineering sector. However, these ties can only be maintained and advanced if new types of equipment are created. The development of cooperation in aircraft manufacturing will boost turnover in the sector. By 2030, the share of aircraft equipment in Ukraine's exports to the SES could reach 7%.

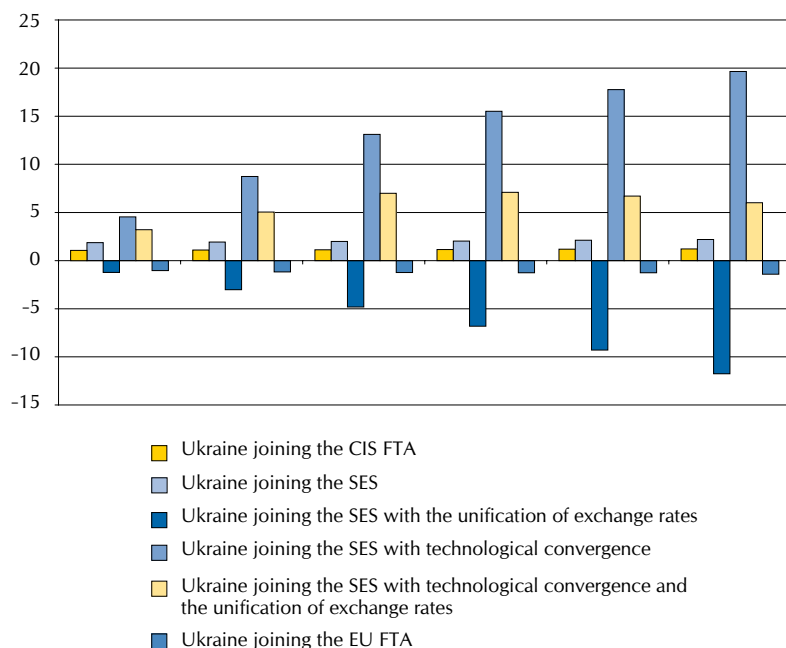
Given the deficit in the shipbuilding production capacities, as well as the country's dominant positions in the post-Soviet area in the development and manufacture of gas-turbine engines for navy, commercial, and passenger vessels, there are significant prospects for cooperation in the shipbuilding sector. By 2030, the share of shipbuilding products in Ukrainian exports to the SES countries is expected to grow to 1.2%.

As for machinery and equipment production, Ukraine's main opportunities are associated with the utilisation of its potential to develop power engineering and with the development and manufacture of equipment for the production and transportation of natural resources, conventional weapons, and military equipment. Additional opportunities for the development of mechanical engineering can arise following the rollout of production focused on the SES markets and providing industrial assembly and subsequent localisation. The most promising areas are the production of investment equipment, construction machinery and equipment, agricultural equipment, and rolling stock. The utilisation of the existing mechanical engineering potential, combined with the launch of industrial assembly projects, can increase the share of mechanical engineering in Ukraine's exports to the SES countries to 20% by 2030.

A comparison of estimates shows that the greatest growth in exports and GDP compared to the baseline scenario (where Ukraine joins neither the EU Free Trade Area nor the SES) is expected in the option envisioning Ukraine's joining the SES with technological convergence but without the formation of a unified currency system.

High export growth is also expected in the scenario where Ukraine forms a free trade area with the EU; however because of the significant increase in imports and a reduction in exports to the SES countries in this case Ukrainian GDP is expected to dip slightly.

A significant increase in GDP is typical of the scenarios that provide for technological convergence. Export growth is expected in the scenarios envisioning Ukraine's joining the SES or the EU FTA. The scenario envisioning the fixing of the exchange rate entails significant negative effects for the Ukrainian economy because of worsened balance of payments. In essence, this prompts the necessity to invest in improvements to economic efficiency, first and foremost in reducing the energy intensity of production. Otherwise, a mechanism must be envisioned for the transfer of capital flows within the SES in order to minimise distortions in the balance of trade and payments. The proposed scenarios suggest that the main criteria for improving the GDP dynamics when selecting customs policies are associated with the expansion of markets for manufacturers and a reduction in expenditures on raw materials and energy commodities through the introduction of new technologies and a reduction in the share of customs payments in their cost. For this reason, Ukraine joining the SES appears to be a more advantageous option compared to the scenario envisioning the formation of a free trade area with the EU, because it affords Ukrainian industries more competitive advantages in the contemplated



**Figure 1.5.**  
Changes in  
Ukrainian GDP  
under various  
integration scenarios  
(\$ billion, 2010  
prices)

common market. This makes it possible to secure financial resources for making the necessary capital investments and modernisation, which will help to further expand trade in the global market.

Over the period of 2011-2030, the maximum cumulative positive effect of integration on the Ukrainian economy is estimated at \$219 billion in 2010 prices.

In assessing the significance of integration effects on the structure of the Ukrainian economy it appears that the scenario featuring the fullest utilisation of the integration opportunities offered by the SES provides for a marked diversification of the economy. The share of mechanical engineering in the aggregate gross output is expected to reach 7.7% by the end of the forecast period. The shares of metallurgy and agriculture are expected to dip slightly. Overall, it is expected that the structure of the Ukrainian economy will become increasingly balanced.

	2010	2015	2020	2025	2030
Agriculture	8.1	8.1	7.9	7.6	7.4
Mining	5.8	5.2	4.3	4	3.7
Food processing (including beverages and tobacco)	9.5	10	10.4	10.4	10.5
Textiles and garment manufacturing (including leather manufacturing)	1.1	1.1	1.1	1.2	1.2
Forestry, timber and pulp-and-paper	1.6	1.7	1.8	1.9	1.9
Coke and petroleum products	4.2	2.6	1.3	0.7	0.3
Chemical production	4.4	4.6	4.8	4.9	5.1
Production of other non-metal mineral products	1.7	1.9	2.2	2.3	2.4
Metallurgy	9.2	8.9	8.5	8.4	8.3
Mechanical engineering	5.9	6.6	7	7.5	7.7
Electric power	4.9	4.3	3.9	3.5	3.1
Construction	3.5	4.6	5.8	6.7	7.1
Transport and communications	9	9.1	9.3	9.4	9.5
Commerce	10.5	10.7	10.8	10.9	11
Services	20.6	20.6	20.8	20.7	20.6
Total	100%	100%	100%	100.1%	100%

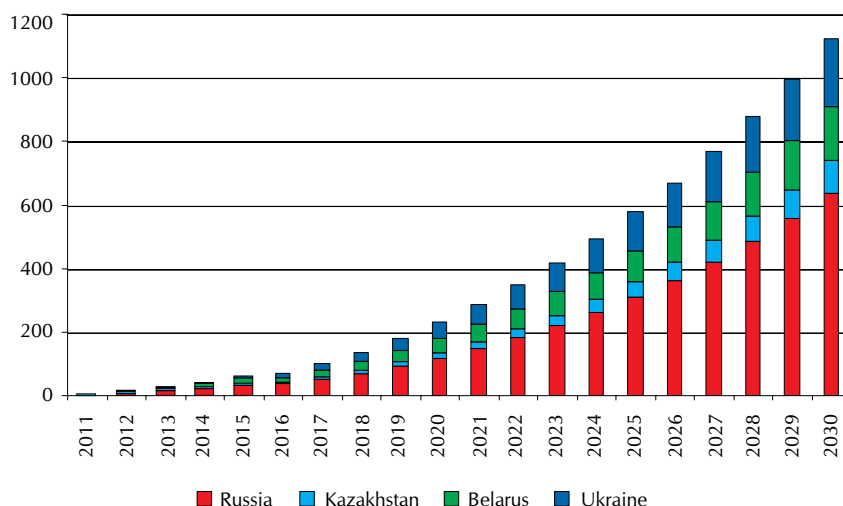
**Table 1.12.**  
**Sectoral breakdown**  
**of the Ukrainian**  
**economy,**  
**in constant prices**  
**(technological**  
**convergence**  
**scenario, %)**

Source: Calculations  
by IEF RAS

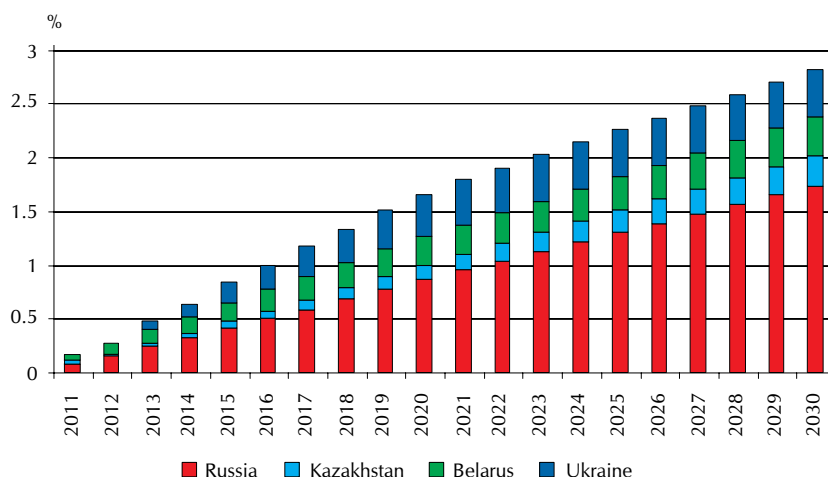
Over the period of 2011-2030, the ultimate effect of the creation of the SES and Ukraine joining it can be assessed for the four countries at \$1.1 trillion in 2010 prices (see Figure 1.6).

By the end of the forecast period, the integration of the SES countries would ensure a gain in the four countries' aggregate GDP of up to 2.8% over the baseline option (see Figure 1.7).





**Figure 1.6.**  
Gain in the four  
countries' aggregate  
GDP from creating  
SES and Ukraine  
joining it (\$ billion,  
cumulative, 2010  
prices)



**Figure 1.7.**  
Countries' contribution to the  
cumulative integral  
effect of creating  
SES and Ukraine  
joining it  
(% of the four  
countries' aggregate  
GDP)

## CONCLUSIONS

The following key conclusions can be drawn based on the findings of our research:

1. The intensification of integration within the SES of Russia, Kazakhstan and Belarus through the fostering of *trade ties*, *industrial cooperation*, and *technological convergence* will help increase their aggregate annual GDP by the end of the forecast period by approximately 2.5% compared to their

aggregate GDP if they do not integrate. Over the period of 2011-2030, the total cumulative effect from the creation of the SES, without Ukraine, is estimated at \$900 billion (in 2010 prices).

2. Because of the existing structure of the Belarusian economy and the main directions of its foreign economic ties, integration in the post-Soviet area is of vital importance to the country, since Belarusian exports to the SES countries can reach up to 35% of the national GDP in the future.
3. Ukraine's avoidance of the integration processes in the post-Soviet area will lead to the preservation of its current sectoral breakdown and, as a result, to a *potential slowdown in its economic growth* because of the impossibility to accelerate export growth.
4. Ukraine's joining the CIS FTA with the current exceptions will have no appreciable impact on foreign trade within the CIS, the growth rates of the Ukrainian economy, or the country's economic structure. In essence, Ukraine's joining the CIS FTA in this format can be viewed as *the preservation of its status quo with insignificant positive effects* for its economy.
5. Ukraine's joining the EU FTA would *worsen the terms of trade in the post-Soviet area*. In this case the SES countries can mitigate the negative consequences of such a move by Ukraine by raising median customs tariffs. Because of a reduction in exports to the SES countries and an increase in imports from the EU (only partially offset by a certain increase in exports to the EU), *Ukraine in this scenario can lose up to 1.5% of its baseline GDP*.
6. The greatest change in the structure of the Ukrainian economy for the sectors with higher processing levels is expected in the scenario envisioning the country's joining the SES with subsequent technological convergence. In this case, *the share of mechanical engineering in Ukraine's gross output is expected to climb from 6% to 9%*.
7. Ukraine joining the SES means that, owing to trade effects, its annual GDP will exceed the baseline GDP by 1% by the end of the forecast period. With technological integration and the fostering of cooperation ties taken into account, *the economic effect can be estimated to reach 6-7% of GDP by 2030*. In this scenario, by the end of the forecast period, Ukraine's GDP is expected to exceed its GDP in the scenario avoiding integration with the SES by approximately 6-7%. At the same time, the share of mechanical engineering in Ukraine's GDP is expected to increase from 6% to 9%. In addition, the share of machinery and equipment in Ukraine's total output is forecasted to reach 6% by 2030 and their share in Ukraine's exports to the SES 20%. The fostering of cooperation in aircraft manufacturing will boost turnover in this sector. In the structure of Ukrainian exports to the SES, the share of aircraft equipment is expected to grow to 7% by 2030. The share of shipbuilding products in Ukrainian exports to the SES is forecasted to

climb to 1.2%. Over the period of 2011–2030, the total positive effect of this integration option on the Ukrainian economy is estimated at \$219 billion in 2010 prices.

8. One of the key challenges of integration is the development of a uniform currency and financial policy for the SES countries. According to estimates, if the SES countries continue their non-coordinated currency policies this can significantly weaken the positive effects of integration. At the same time, the harmonisation of exchange rates can create significant problems for the SES countries that are dependent on the import of energy commodities (particularly when prices rise). Alternatively, mechanisms can be envisioned for the transfer of capital flows within the SES countries in order to minimise distortions in the balance of trade and payments. If these mechanisms are created the harmonisation of exchange rates would be the most advantageous scenario for further intensification of integration in the post-Soviet area.
9. Over the period of 2011–2030, the total cumulative effect of the creation of the SES and Ukraine joining it on the four countries can reach \$1.1 trillion in 2010 prices. Broken down by countries, this effect is expected to approximate 14% of Belarusian GDP, 6% of Ukrainian GDP, 3.5% of Kazakh GDP, and 2% of Russian GDP. Belarus, Ukraine and Kazakhstan are expected to benefit from integration to the greatest extent in terms of per capita effects while Russia is expected to benefit from it to the greatest extent in absolute terms.

# 2

## Eurasian Economic Integration: Origins, Patterns, and Outlooks

Tatyana  
Valovaya

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Over twenty years ago, on December 8-10, 1991, two very important geopolitical events happened in Europe and Eurasia.

On December 8, 1991, a decision to dissolve the Soviet Union was taken in Belovezhskaya Pushcha. And on the next day in Maastricht, leaders of the European community decided to create the European Union (EU).

The coincidence in the timing of these two events allows me to reword the famous proclamation of the French royal ritual: "The Union is dead, long live the Union!"

Indeed, the Soviet Union died, but another union emerged on the globe – the European Union, which is, obviously, built on absolutely different economic and political principles. When new independent states began to search for ways of interaction after the breakdown of the Soviet Union, they used (and continue to use), the European Union as a reference point, as opposed to the Soviet one.

This is a very important, key aspect – one that is practically disregarded. All initiators of the integration processes in the post-Soviet space chose and continue to choose the European Union as a model, despite its own problems, which have become very acute. However, this is the only functioning integration model that is used as an example in Eurasia, Latin America and other parts of the world.

The history of Eurasian integration is actually an attempt to build something similar to the EU.

This history is meandering, complicated, controversial and sometimes very dramatic.

...The very next morning after the breakdown of the USSR, the former Soviet republics understood that they needed each other's assistance in building their sovereignty and independence. They had been a single economic mechanism for too long a time to begin to function independently overnight. The beginning of the 1990s was flagged with various integration initiatives, including the 1993 Agreement on the Formation of the Economic Union, the 1994 Agreement on the Formation of the Free Trade Area, and the 1994 Agreement on the Payment Union, in an attempt to preserve the shrinking, as *la peau de chagrin*, rouble zone.

In the mid-1990s, it became clear that not all of them were interested in real integration and a multilevel structure began to form in the post-Soviet space.

In 1995, first agreements on the Customs Union of Russia, Belarus and Kazakhstan were signed, to which Kyrgyzstan and Tajikistan were later added. These were, to a significant extent, framework agreements or memoranda of intent. Yet, a higher level of interaction emerged – a core of the states that were ready for more advanced forms of cooperation. At this stage, however, they did not understand that they would have to sacrifice their sovereignty for these purposes or, to put it more precisely, to transfer a part of their sovereignty, on a purely voluntary basis, to a supranational level. For the moment, these "advanced" countries were living to an "integration plus sovereignty" principle.

In 1999, the five countries signed the agreement to form the Customs Union and the Single Economic Space. The same year, Russia and Belarus created the Union State with the aim of making it a fully-featured economic, currency and political union. Thus, another level of integration appeared.

In 2000, the five countries transformed into Eurasian Economic Community, and the "triad" of the Commonwealth of Independent States, EurAsEC and the Union State emerged in the post-Soviet space. These three unions adopted hundreds of documents, a host of plans of actions, and several institutional reforms. However, no real integration happened despite their statements. No one went beyond the level of a free trade freea.

The main reason for the inefficiency of all these projects was that they formally copied the models of European integration, with the creation of similar institutes and the proclamation of similar objectives. In essence, however, these first attempts of integration disregarded the key laws of the integration process. In spite of this fact, these first attempts were not useless as they established a basis for making integration practical.

The turning point was marked in 2003, with the launch of a project to create the Single Economic Space across four states: Russia, Ukraine, Belarus, and Kazakhstan. It was clear from the very beginning that this project did not have much chance of success. For this reason, the participants focused primarily on

the “intellectual” side of the issue. The preparation of the SES Blueprint and Agreement were not viewed as traditional interstate negotiations where they could bargain over their positions or concessions. The objective was to prepare a comprehensive and viable project that could be implemented, given the existence of political will as a matter of course.

This was a revolutionary document for the post-Soviet area. It provided for the creation of a supranational body, the transfer of a part of national authority to it and the adoption of decisions subject to the economic weight of the states. All these are universal laws and principles of integration, which were at this point acknowledged for the first time by post-Soviet states.

The SES Agreement was signed and ratified in 2003 and although Ukraine later withdrew from it, the remaining three participants continued to fulfil it. This process could have continued until now if the global financial crisis had not taken place. When all countries in the world began to look for mechanisms to minimise its consequences in 2008, Russia, Belarus and Kazakhstan saw the consolidation of economic effects and deep economic integration as one of the possible tools.

Therefore, we should “thank” the global economic crisis for the successful development of integration over the past four years. It was the crisis that made these countries able to understand the significance and necessity of integration.

The CU of Belarus, Kazakhstan and Russia was formed on the existing base (in a rather accelerated fashion) on January 1, 2010. This was an unexpected turn of events for many people, including those abroad. This was not because timely information had been unavailable, quite the opposite – there had been many talks at different levels but no one had believed them. As a quick reminder, the creation of the CU had been in discussion since early 1990s and everyone tended to see these talks as traditional political statements or wasted words that would not bring about any real results.

Therefore, when this idea finally materialised many people were surprised at the appearance of a new formation. We should do justice to our foreign partners who regarded this process with understanding, recognised its conformance to global economic trends and acknowledged that it did not contradict in any manner to the standards and principles of the World Trade Organisation (WTO). I would like to specifically point out that Russia was admitted as a member of the WTO after it had become a member of the CU. It is obviously not only the evaluation of Russia’s efforts to harmonise its laws with the requirements of the WTO but also the recognition of the fact that the CU is a structure which meets the requirements of global economy. After joining the WTO, Russia’s tariff obligations will become mandatory for the whole territory of the CU. As a result of this, the states signed a special

international agreement and Russia's obligations before the WTO will be carried out in a rigorous fashion.

Seventeen agreements were quickly signed on the basis of the CU to form the Single Economic Space. If you wish to draw an analogy with Europe, this is the "Eurasian version" of the EU single internal market. The agreements took effect on January 1, 2012.

The implementation of integration ideas and their transition from theoretical and bureaucratic concepts has driven interest to their conceptual basis. Where does integration begin? What are its stages? What are its laws and principles? What is being actually built in Eurasia?

These issues that in our countries were previously of interest to a narrow circle of experts have become topical for politicians, officials, business people and the general public. This is very encouraging because the SES project requires broad public support – even more so than the CU. The CU has been in development for fifteen years and in the end no one believed it was a serious project. When it was finally created it amazed those in the member states or abroad.

The SES and the Eurasian Economic Union are expected to produce another effect. This project will inevitably give rise to a host of myths. Some people will expect, with hope or horror, a revival of the Soviet Union. Russia's neighbours will inadvertently become anxious about the reinstatement of Moscow's "imperial ambitions". The Russian will be concerned whether they would "again pay for everyone". All this will happen against a very significant background of sympathy with integration trends among the general public.

However, the national egoism of our companies is equally, or I would say already, significant. They do not want greater competition, even from weaker competitors. There is no sense in ordering everyone to "parade" towards integration. Companies need to see its advantages as European companies saw them in the common market, although they faced a stiffer expansion of competition. For this reason, thorough work with the general public and the business community is needed.

On the other hand, we have thousands, possibly tens of thousands of research studies on integration in our countries. The majority of them begin to formulate its theory with the statement that the objective preconditions for the formation of integration tendencies formed in late 1950s.

Here's an important quote: "One of the objective tendencies in the modern global economic relationships is the formation of regional integration unions inspired by technological progress, intensive centralisation and concentration of production and capital, which gives rise to the need to bridge the gap between internationalisation in all areas of global economic ties on the one hand and

the existence of separate, relatively isolated national economic complexes on the other”.

Overall, this statement does not raise any objections. I still agree with it on the whole; it opened my own Ph.D. thesis in 1995.

However, today, after fifteen years of participation in the practical building of integration, I have to admit that this statement explains only the economic component of integration. It is important, but it not the only factor.

It does not answer why integration is so successful in Europe and why it is so slow, compared to the EU, in other parts of the world. Indeed, the EU is, at present, the only regional union that went beyond a free trade area and a customs union and that created an economic and currency union and supranational mechanisms that have significantly restricted national sovereignty.

Surely, we can suppose that Europe, divided into national economies, has more clearly understood the conflict between the internationalisation of the global market and the existence of national borders. It is understandable why the US, at least because of the scale of their economy, did not have a need for a continental union for a long time and why the prototype for an integration union, the North American Free Trade Area, began to form at significantly later dates.

This is a logical explanation. However, what about Japan, which is characterised by economic openness, its dependence on foreign markets and, at the time, stable economic growth? Why didn't it manage to pull together around itself an efficient Asian integration union? Why all numerous regional unions that exist today are still so far from the EU?

Is it possible that the reason is that, in addition to the economic component, there is an important political, mental or psychological component, without which integration cannot succeed?

The founders of the European Union were inspired with the “European idea”, – the idea of common spiritual and cultural values of the European civilisation. Integration for Europe is, in essence, a return to its roots. In different historical epochs, be it the Roman Empire, Charlemagne's empire, the Holy Roman Empire of the German Nation, or the Habsburg or Napoleon's empires, Europe was united for long periods of time. The collapse of an empire caused lengthy fratricidal conflicts on the continent, which culminated in the twentieth century when the flame of old European conflicts burst out with new military power and plunged the world into two world wars.

In addition to interstate conflicts, Europe suffers from a host of in-country tensions. Who can intelligibly explain where the Basque, Irish, Corsican and



other forms of separatism originate from today? They all have their sources in Europe's past. It is difficult to delineate a "correct" state border in Europe today because there will always be those who disagree.

The idea has risen that it would be easier to reinstate the former unity on a new basis, and the European community was invented for this very purpose. I hope economists will pardon me for my statement that the founders of the EU had thought not about growth and modernisation but rather how to create an integral European mechanism, in which former state borders would lose their importance and practically dissolve. They hoped this would eradicate causes for new European wars.

It is no accident that geographically the united Europe of 1957 reminds that of Charlemagne's empire. Only the original European Six that could prepare, sign and ratify the Treaty of Rome, a document that remains even today an unrivalled example of revolutionary economic thinking.

It is difficult to believe that only ten years after the destructive war the winners and the defeated countries voluntarily agreed to create a supranational union, in the name of which they had sacrificed their national sovereignty (which they had been protecting only a short time ago with arms). I am convinced that the Treaty of Rome was made possible and signed because it had been prepared by the countries that were linked with very strong, although controversial historical ties.

Having consolidated, the Six began to involve other countries that at different times were parts of previous European communities. Europe restored the borders of Charlemagne's empire and began to chase, in a gradual fashion, the ghosts of other former empires. It remembered about the empire of the Caesars and began its movement toward the Mediterranean and Great Britain. Then it remembered about the Habsburg heritage and opened its doors for Central Europe. It encompassed the Scandinavians, whose ancestors, the Normans, had at one time conquered half of Europe and settled there. For all these countries, the joining to the EU was the return to Europe, and the implementation in practice of the great European idea.

This idea was born in the Middle Ages when many intelligent scholars dreamt about the creation of a single European Christian republic, and it acquired its modern shape in the 19<sup>th</sup> century when Victor Hugo proclaimed the concept of the United States of Europe. Without paying attention to the criticism from his contemporaries who considered this idea absurd (France and Germany regarded each other at the time as eternal enemies), in August 1849 at the International Peace Congress, Hugo presented a speech that became one of the fundamental thoughts in the European philosophy:

"A day will come when you France, you Russia, [...] you England, you Germany, you all, nations of the continent, without losing your distinct qualities and your

glorious individuality, will be merged closely within a superior unit and you will form the European brotherhood [...] A day will come when we shall see those two immense groups, the United States of America and the United States of Europe [...]"

He prophetically called for the creation of a single "continental currency", resting on European capitals and driven by the activity of 200 million Europeans.

In other words, in addition to the economic efficiency of integration, the Europeans have always had an ideological component. The EU could not have managed to do what it has done without it. This is precisely what many other regional unions lack – they cannot formulate clearly their overall objective. A federation? Or a confederation? They do not understand why they should sacrifice their national sovereignty and, therefore, resist the process, making integration efforts useless.

To put it differently, the development of integration would be difficult without an inspiring, be it even ambiguous, idea, even when all necessary economic components exist. In my opinion, an optimal integration zone is a region where, in addition to economic prerequisites, mental prerequisites exist that often stem from the common past.

Is the experience of the EU, therefore, absolutely unique? No. It is universal because there are other regions on the globe, in addition to Europe, which, in my opinion, are in an optimal integration area. Eurasia is one of these regions, but not in a purely geographic sense as a continent spreading from the Atlantic to the Pacific – I mean its median part, which is equally different from its European and Asian ends.

Was Eurasia united in the past? It certainly was. The Scythian union existed before Christ, which then gave place to the Turkic Khaganate, which existed in 6–7<sup>th</sup> centuries A.D. and stretched from the Yellow to the Black Sea. The Turks were replaced by the Mongols headed by Genghis Khan, who came from Siberia. Then, after a period of complete disintegration, Russia took the initiative in the 15<sup>th</sup> century with its movement eastward to the Pacific Ocean. The Russian Empire then yielded to the Soviet Union and the Soviet Union to post-Soviet regional unions. Over ages of living together, the Eurasian peoples have obviously developed a common mental space as well as common traditions and behavioural patterns.

It was therefore no accident that the "Eurasian idea" was born in the 1920s. The October revolution seemed to bury the Russian Empire forever. Yet, even as early as 1922, the Soviet Union emerged in its place as a state with an absolutely different socio-political and economic structure, but with practically the same borders. There is no other such instance in history where a multinational empire collapsed and was instantly revived.

What was it that tied the fragments of the former Russian Empire together? The new states with a similar social order that appeared in its area found themselves surrounded by enemies – and a common enemy always fosters unity. However, was it only the Bolshevik ideology and the military threat that made the peoples to want to unite? Russian emigrants who opposed Bolshevism could not believe it.

In "civilised" Western Europe, people with a European education and a brilliant knowledge of the world's history, politics and philosophy felt that European strangers should have been closer and more relateable to them than the "barbarian Asian Russians". Yet they did not deem themselves the Europeans. They understood all of a sudden that they were the Eurasians with their unique mental and social peculiarities.

For this reason they believed that the basis for the revival of the Russian Empire lay in Eurasia's specific geographical, psychological or, as we put it today, mental and cultural factors. In their opinion, the Eurasian mentality meant the priority of collectivist ideology over individualism, the eternal ideals over instantaneous values, and the spiritual values over material ones.

The Eurasian idea obviously did not fit the communist ideology or the administrative and command system; there were other factors that cemented the Soviet Union, and their dissolution caused its breakdown. The interest to the seemingly forgotten Eurasian doctrine emerged in the wave of this collapse. This was the doctrine that, despite all its internal controversies, managed to offer a real uniting dominant idea.

So, Eurasia also has its idea of unity. However, why were these ideas born in Europe and Eurasia? Proceeding from the postulate that it is social being that determines consciousness, I would assert that uniting ideas are only born where they have a solid material base, not just an economic one.

Economic efficiency is a necessary precondition for integration, but it is not in itself sufficient. A sufficient precondition appears when not only economies, but also peoples as a whole are ready for integration.

In my opinion, the theory of ethnogenesis by Lev Gumilev, whose 100<sup>th</sup> anniversary we celebrate this year, explains the phenomenon of appearance of similar uniting ideas. As it is recorded, Gumilev described the historical process as interaction of developing ethnos with landscapes they occupied and other ethnos. He defined ethnos as a "stable group of people that opposes itself to all other similar groups, has its own, original internal structure, and a dynamic behavioural pattern".

Ethnos have limited periods of existence, of approximately 1,200-1,500 years, during which they pass a number of stages in their development, "from dawn till dusk". Each of these stages has a pattern of behaviour of individuals, peoples,

ethnicities, nations and even civilisations, which is determined by their level of passionarity. This basic pattern changes objectively depending on the phase of ethnogenesis, each of them lasting for several centuries.

According to Gumilev, the highest level in the ethnic hierarchy is a superethnos, which consists of several ethnos that emerged simultaneously in the same region and were connected by economic, ideological and political relationships, and which manifests itself in history as mosaic integrity.

Among the superethnoses, Gumilev specifically distinguished the European one, which was previously "the Christian world", and the Eurasian one that populated the median part of the Eurasian continent.

I suppose it was no accident that the European and Eurasian ideas were born in the frameworks of these superethnoses. In other words, a uniting idea cannot appear without a solid material base formed by ethnic structures.

Soviet science never recognised Gumilev and Russian science doesn't either, despite numerous republications of his works. Few people dare to declare him a charlatan, as he was a son of respected parents and a man who lived a hard life. However, mainstream science does not recognise this scholar.

Where does this inattention, if not to say ignorance, stem from? Gumilev's theory seems to be in line with the ideas of cyclical development of civilisations, including those by universally acknowledged scholars such as Toynbee.

I believe there are two reasons. The first one is that Gumilev's writings were very simple, maybe too simple. Humanitarian sciences do not tolerate simplicity, which is deemed to be worse than plagiarism.

Another reason is that Gumilev contradicted the proletarian internationalism. He dared to state that not all nations could co-exist comfortably with each other. He does not blend with Russian nationalism. He believed that Russia did not exist at all as an independent ethnic structure. The Russian (or, as he sometimes calls it, Eurasian) ethnos in his view was an ethnos that populated the former Russian Empire, in which the Slavic peoples blended firmly with the Finno-Ugrians, the Mongol Tartars and other descendants from Eurasian steppes. The common home to this ethnos was not Russia, but Eurasia.

In my opinion, however, it is Gumilev's concepts that make it possible to explain why economics, or politics, are not the only determinant factors in integration and that explains why it includes the ideological and mental component.

I would make two fundamental conclusions. The first one is that integration is a form of the state organisation of a superethnos. I anticipate an objection that the idea of integration appeared only in the past decades while superethnoses existed for hundreds of years. However, superethnoses, as ethnos, pass several stages in their development with evidently different forms of their state

organisation. At the "acmatic"/development stage superethnoses organise in an empire, in my opinion. In Europe this was Charlemagne's empire, which the Europeans zealously attempted to revive until approximately the 17<sup>th</sup> century. At the climax stage, when, according to Gumilev, "they [ethnoses], governed by the dialectic law of the unity of opposites, find areas of activities while "maintaining" a stable balance in the continuous struggle with each other", these are nation states, which are very similar and have many things in common, possibly including ethnic and religious components, and which quarrel or are at war at times and are united at other times. This was what Europe looked in the 17-20<sup>th</sup> centuries.

At the inertial stage it is integration. This is the European Union.

The history of the Eurasian superethnos confirms my hypothesis. During the "acmatic"/development stage, it existed in the form of the Russian Empire. During the climax stage, which occurred in the 19-20<sup>th</sup> centuries, this was in essence a unitary state. It was no accident that the tsarist Russia was called "the prison of nations", and the USSR tried to breed a new community – the Soviet people with smoothed ethnic diversity. This attempt failed and the Eurasian ethnos divided into nation states. Now we witness the end of the climax stage and Eurasia is entering its inertial stage, which means that the Eurasian superethnos is ready for integration.

Since integration is a form of the state organisation of a superethnos, another important conclusion follows that integration has clear, objective borders - the borders of the superethnos.

This provides an explanation for many things, including the Europeans' doubts about admitting Turkey to the European Union. The reason is not simply Islam. The reason is that Turkey belongs to an absolutely different superethnos.

On the other hand, Ukraine, Moldova and Belarus consider themselves part of Europe and Europe agrees because their western areas belong to the European superethnos. These countries are situated on an ethnic "dividing line" of our continent, which can become geopolitical if the European and Eurasian superethnoses do not unite. We'll discuss this further later.

Therefore, the application of Gumilev's concept onto the modern map of the world helps reveal the objective laws of many geopolitical processes.

The European superethnos is now in the inertial phase, "the golden autumn" of civilisation, and is integrating quickly. At that, some decisions, including the quick expansion of the European Union, cannot be explained by economic efficiency. Quite the contrary, as sometimes they are taken in defiance of economic priorities. The key is in the underlying desire to "unite and strengthen" the European superethnos which is eroding from inside because of the fast pace of immigration.

The North American ethnos is rather young and it is at the “acmatic”/development stage. This stage is characterised by aggressive wars abroad. Indeed, we witness a change in the American ideological model. The country, which had been developing its territory before and had taken part in the world wars of the 20<sup>th</sup> century contrary to the will of its own nation, has engaged in one reckless military undertaking after another since the 1950s. However it comes as no surprise to admit that the North Americans are, according to our hypothesis, pervaded by the “imperial syndrome”.

As for the Chinese superethnos it is traditionally viewed as a very old one, at the stage of convolution. I cannot agree with this statement. In my opinion, it is in the very beginning of a new cycle. I also disagree that (in the way Gumilev’s followers traditionally state it) the Islamic superethnos, as a contemporary of the Eurasian one, is at its climax stage.

I believe that a new passionary impetus was given to China, India, Pakistan, Iran, Saudi Arabia, and the Near East in the 19<sup>th</sup> century. The incubation phase of new superethnoses is coming to its end or has probably ended already. We witness the birth of two new superethnoses, the “new Chinese” and “new Islamic” ones that are based on fundamentalism. The Arab spring was a vivid confirmation of this. We witness how the remnants of the old, “religiously tolerant” Islamic ethnos, which gravitated towards Europe, gradually become history with our own help.

Since integration is a form of organisation of a superethnos, it becomes evident why Russia and China, or Latin America and North America can integrate within themselves, but not with each other.

Latin America received a passionate impetus in the 15<sup>th</sup> century when the Europeans began to investigate the continent and is now at the inertial stage. It is indeed ready for integration and its integration unions are quite viable. The US and Canada, which form a single superethnos, are de facto a viable integration union. However, they will never integrate with Latin America.

The post-Soviet space can and should integrate. Otherwise the Eurasian superethnos will be pulled apart piece by piece by its neighbours. If they do not integrate, many Eurasian nations will possibly cease to exist as a part of the Eurasian superethnos and will become parts of other superethnoses: the European one in the west, the new Islamic one in Asia and, possibly, the new Chinese one in the east.

For this reason the significance of integration in the post-Soviet space goes beyond geopolitical objectives and is closely connected to the future of the Eurasian ethnos. Only true integration will make it possible for the Eurasian ethnos to preserve its identity and geographical location when it is surrounded by young and energetic Islamic and Chinese superethnoses.

In addition, Eurasian integration does not contradict the more global project to integrate the space from the Atlantic to the Pacific. Quite possibly, the post-Soviet space and Europe can integrate in the future and give birth to a new superethnos. All the necessary prerequisites exist. Europe, which is ageing ethnically, simply has no other choice. It needs fresh blood and new "passionate people" to help it revive.

Europe is ready for regeneration, for the birth of a new superethnos on the basis of the old one. What will it be? Possibly, the European and Muslim one if Europe merges with the remnants of the old Islamic ethnos, which has been forced out from its traditional borders.

Yet, there is another option, the European and Eurasian one, one that frightens Europe for the moment. Common Europeans associate Eurasia with the Huns, Mongols, Tatars, and communists. However, they also feel that this option is preferable. This is reflected, among other things, in Russia and the EU's decision to form "four common spaces", including the economic one.

It is all the more possible because Eurasian integration is developing in accordance with universal laws whose existence is proved by the experience of the EU.

The European Union is indisputably the primary source and pioneer whose experience was used to prepare the documents of the CU and the SES and will undoubtedly be used in the preparation of the legislative framework of the European Economic Union. The European Union has tried the integration concept in practice blindfolded (not always supported by theoretical research). Our task is to thoroughly study the experience of the EU and learn from the mistakes of the others, a host of which have already been made and will surely continue to be made by our European counterparts.

This experience helps us formulate the universal laws of an integration process: stage-by-stage development, supranationality, subsidiarity, and convergence.

The first law is stage-by-stage development meaning an inevitable rise from lower to higher stages of integration.

We all know what happens to a car if we start with the third or fourth gear. The engine will stop. A similar thing occurs with integration – its stages cannot be avoided.

Integration begins with the first gear, a free trade area. At this stage, member countries remove, in a gradual fashion and in agreed timeframes, mutual trade barriers while remaining absolutely free in economic relationships with third countries. For this reason, they preserve customs borders and customs posts between each other to control the origin of goods that cross their frontiers and exclude those goods that are imported from third countries using preferential

conditions of import into each other's territories. The CIS is currently at this stage.

The second stage of integration is the customs union. At this stage, a single customs tariff and a uniform trade policy with respect to third countries is adopted. Customs bodies are gradually eliminated on the "internal" borders of the member states of such a union and transfer their functions to customs services on common external borders, which now become the common borders of a single customs space. Supranational bodies, which are vested with certain coordination and management functions, begin to function at this stage.

This is the stage Eurasia entered into on January 1, 2010.

The next stage of integration is the single economic space – meaning a single internal market, which provides the so-called "four freedoms" (free movement of goods, people, services and capital) and a uniform or coordinated policy in key economic sectors.

Key economic sectors vary depending on the stage of the SES, the specifics of economies, and their level of development, as well as that of global economy. Fifty years ago, coal and steel were the key sectors, which were regulated by the Europeans in the first place. Other sectors dominate today. Accordingly, the set of the SES elements will change in an ongoing fashion while competition (in a broad sense of the word) policy and technical regulation will obviously remain key elements. Without them even the customs union will be inefficient. The Single Economic Space is being built in stages from January 1, 2012.

The next stage is the economic and currency union, marked with the introduction of a single currency. Here, the Europeans had to literally move blindfolded, running before they could walk, stumbling and then beginning from scratch.

The reason for that was simple, in my opinion. No one thought about currency integration when the Treaty of Rome was being prepared. There was simply no need for it. The Bretton Woods monetary system ensured a rather high degree of stability of the world's currency system, fixed parities, and a common equivalent (gold).

The founders of the EU could not foresee that this system would collapse in some fifteen years, and that the unstable 1970s would come when the EU countries would clearly understand what it meant to live in a customs union without protective trade measures and with unstable currency rates. To improve their competitiveness, the EU countries began to extensively make use of currency dumping.

To avoid this they decided to speed up the process of currency integration. They were not ready for a comprehensive economic and currency union at



the time and did not need it for internal reasons; however, external instability forced them to begin what they were not prepared for.

The actual currency union and the single currency appeared only when they became necessary in the actively developing single economic space, when national currencies turned out to be a serious economic barrier.

Therefore, economic integration has its internal dynamics. Each stage leads to the next one. To continue the car analogy, it could be said that the next integration gear can be used when the integration engine has the necessary number of revolutions and achieves the necessary speed. Then the engine requires the use of a higher gear.

Indeed, as integration moves toward its higher stages and barriers are removed in the way of the single economic space, the remaining barriers become increasingly inefficient. The economic policy of one of the countries begins to impact other countries in an integration union to a stronger extent and can cause them to take preventive or protective measures. These measures begin to threaten integration achievements and a challenge arises whether to make another breakthrough or to accept the loss of the existing integration accomplishments. It is no accident that the integration process is sometimes compared to riding a bicycle: any stop can lead to a fall. So, integration is an objective, self-developing process with its internal logic.

The second key law is supranationality. It appears at the stage of the customs union and solidifies significantly at the stage of the formation of a SES.

National regulatory tools become inefficient when economies become closely tied and a common market begins to function in practice. Finally, countries strive to unite their efforts to find other, joint ways of implementing economic policies. This may be coordination on an interstate basis, with the preservation of sovereignty by nation states and the adoption of decisions in primarily a unanimous fashion or on a supranational basis when supranational institutes are created and vested with a part of state powers.

The post-war decades have demonstrated rather convincingly that the combination of interstate and supranational mechanisms of regulation, with a gradual solidification of the supranational component, is a universal element in the development of regional integration. This approach was utilised in the SES documents as well.

Again, the EU experience was used. When it made an attempt to analyse why thirty years after the "common market" had been proclaimed it still had barriers to the movement of goods, services, capital and labour in the mid-1980s, it arrived at a conclusion that one of the causes that prevented the necessary joint steps from being taken was an insufficient degree of supranationality. This resulted in the 1986 adoption of the Single European Act, which introduced

majority voting as a general rule and made the making of decisions by consensus an exception.

Therefore, a single economic space is sustainable only when supranational bodies are formed and vested with competency that can be gradually extended. At the same time a supranational law, which would prevail over national laws, and a majority voting system, where the right of veto is used in exceptional cases only, are needed.

Subsidiarity is the third law of an integration process. We do not use this term in our integration efforts at the moment and the Europeans only began to use it not so long ago, in early 1990s when their integration process began to glitch. This is another mistake made by Europe that we should avoid.

Subsidiarity means that decisions are taken at the levels of state management where they are most efficient. Everything that can be resolved at lower levels is done there and what cannot be resolved at lower levels is passed to a higher level. This helps avoid the excessive centralisation of decision-making at the higher levels of state. Friedrich August von Hayek wrote that, "with its centralism, inefficiency, an excessive devotion to legal issues, etc., federalism without subsidiarity is a step toward feudalism".

With respect to the EU, the principle of subsidiarity means that the community is vested with those functions only, which cannot be fulfilled by its member countries in an efficient manner any more.

The fourth law is convergence. The development of integration processes leads to significant coordination of economic policies of member states. A single trade, customs and tariff policy appears at the stage of the customs union. Competition and subsidising policies are adopted and policies in certain sectors become coordinated at the stage of the SES. A single monetary policy appears at the stage of the currency union.

A single policy means common goals and regulatory instruments. However, common goals can only appear and be fulfilled when main economic indicators are aligned and the levels of economic development and economic structures are close. How can a common policy be implemented when basic conditions differ? Convergence, or the alignment of main economic indicators, is needed to make an integration system stable.

All these laws should be carefully taken into account in building the Eurasian Economic Union. This is the only way to make it successful. What is the outlook for Eurasian integration?

On January 1, 2012, we entered into the stage of the single economic space. It is currently based on seventeen international agreements. Obviously, it is premature to talk about the completion of its formation.

I remember a phrase, which I often heard from the Europeans in the 1990s when they built and then improved their internal market. They said that building a single internal market was like a repair. It could not have been completed and carried on without cessation. Indeed, new spheres that need to be regulated and new challenges that need to be faced emerge continuously. In fact, even Europe, which made the project of a single internal market effective since January 1, 1993, still continues to work in this sphere.

We are at the very beginning of this road. These seventeen agreements need to transform into another eighty documents, including international agreements. This work is planned for the period until 2017.

The work to form the single economic space is based on the main principles the European Union used.

The most important of them is national treatment. Our businesses are gradually provided with an opportunity to function on an equal basis in all the three countries without discrimination between "nationalities". This means in fact that national administrative systems now face competition: businesses can work in the jurisdiction which is the most efficient and the least burdensome.

This form of competition is very useful and efficient for the modernisation of state structures.

Another key element of the single economic space is the principle of mutual recognition. Everything that has been legally produced in any of the SES states should have a legal opportunity to be sold or used throughout the whole space. This includes goods, services, certificates, passports, and graduation certificates.

Finally, there is the principle of integrity or what the Europeans call *acquis communautaire*; the achievement by the community. Our measures to form the SES are also interconnected and interrelated. The states cannot implement them in a random fashion, that is to say, "I'll do this because I like it and I won't do this because I don't like it". The SES is a "table d'hôte", not a menu in a restaurant where you can choose what you like. It should be ordered and eaten in its entirety. This is very important to the process of potential expansion: a country can join Eurasian integration in a comprehensive fashion only.

A colossal market is being formed based on these principles, with 170 million consumers, unified legislation, and free movement of capital, services and labour.

It is of crucial importance that the SES is based on uniform standards and requirements for goods and services, the majority of which will be harmonised with the European ones, and on coordinated approaches to key areas such

as macroeconomics and competition, technical regulations and agricultural subsidies, transport, natural monopolies' tariffs, and, as it can be expected in the near future, a single migration policy.

Eurasian integration has a clear institutional structure. The single regulatory body managing the customs union and the SES is the Eurasian Economic Commission. It includes a standing board composed of nine ministers.

The Eurasian Economic Commission is the first supranational integration body in the history of our three countries, and is envisaged to be neutral, with respect to the member states, and prevent dominance by any of them. One of its main functions is to prepare proposals on further integration in the framework of the CU and the SES.

One of the Board's paramount tasks is the possibility and necessity to develop dialogue with the business community, with which we would like to cooperate, and form transparent and clear rules of doing business throughout the Single Economic Space.

Now, a look to the future.

By January 1, 2015, all the legislative framework of the CU and the SES should be codified. Eurasian integration, as distinct from European one, still lacks a fundamental document. It does not have anything similar to the Treaty of Rome or its subsequent modifications. It has a legislative framework of more than 100 international agreements. These agreements were written in different periods and although the majority of them are new, made in 2007-2010, this framework includes documents that were made in the second half of the 1990s.

However, even new documents are written by different teams of negotiators and they sometimes overlap or have identical provisions stated in different legal formulae, which can complicate their implementation, or have some gaps.

Therefore, there arises the need to form a single legislative framework. Legislation needs to be systematised, the current regulatory standards need to be thoroughly analysed, and disagreements and controversies in regulation need to be eliminated.

The presidents required that the codified document be prepared and take effect not later than on January 1, 2015. The Eurasian Economic Union should also start its work based on this document no later than January 1, 2015.

The Eurasian Economic Union will be built on the basis of the comprehensive development of the SES, the improved coordination of economic policies, and stronger cooperation in the production, agricultural and other sectors.

The formation of the Eurasian Economic Union will definitely change the appearance of the post-Soviet space and Eurasia on the whole.

A parallel with the EU is again useful. While its current problems stem from its quick (I would even say rampant) expansion and not always well-grounded inclusion of new countries in the eurozone, the problem of the post-Soviet space lies in its excessive fragmentation into those who really want integration and are ready for it, those who want it but cannot join for economic reasons, and those who could join but do not want and are not ready to be satisfied with just advanced economic ties and a free trade area.

The CIS has fallen into pieces of unions. For better or for worse, this is again fully in line with the EU's experience. Let us remember that European federalists had also begun with the creation of an organisation which did not turn into an integration union, but became later the Council of Europe. The supporters of real integration had made numerous attempts before they prepared the Treaty of Rome, which still remains a revolutionary document.

What will we achieve? We have four levels of integration today: the CIS, EurAsEC, the Customs Union and the Single Economic Space, and the Union State of Russia and Belarus. It is quite possible that with the expansion of the customs union with Kyrgyzstan and Tajikistan who already express their interest in joining it, the CU and the SES will organisationally extend to EurAsEC. The Union State of Russia and Belarus will become a partner of this new union, more advanced in certain areas such as foreign politics and the military sector, but identical from the economic point of view. In the longer run, the Eurasian Economic Union will obviously acquire functions in the humanitarian and social sphere, and transform into a fully-fledged Eurasian Union.

Therefore, two levels of integration will co-exist in our space, the CIS and the European Union.

The CIS will operate as an interstate union, which economically won't go beyond free trade and elements of the single economic space and which therefore does not envisage the creation of supranational institutes. This will be a common denominator of interaction that will be satisfactory for all post-Soviet states.

The Eurasian Union will become a supranational integration association, which will gradually move from the Single Economic Space toward the economic and, in the longer run, currency union.

This internal orderliness and balance in the Eurasian space will make it possible to better organise economic ties on our continent and I hope that no new barriers will emerge. If we remember the discussions that took place in the period when Europe was building its single internal market, many people

were cautious that the process would finally result in a so-called “fortress Europe”. However, very few of them remember this today because this did not happen.

Today’s discussions are concerned with whether Eurasia would become isolated from the rest of the world.

I’m absolutely convinced it won’t be. The Eurasian Union is being built as a regional association on the same principles that were used for the creation of the European Union. It is intended to partner with both the European Union and the dynamically developing Asia-Pacific.

The Russian Federation and the European Union have been discussing the formation of a single economic space since 2003. Now it becomes clear that this single economic space can be the space encompassing the European Union and the emerging Eurasian Economic Union.

In the process of forming this space, Belarus, Kazakhstan and Russia are obviously interested in becoming harmonised with European counterparts in the use of the world’s best practices, including international standards and customs administration, among other things. Accordingly, what the three countries do for themselves cannot contradict in any way to the work they plan to do with the Europeans.

In 2012, Russia will chair Asia-Pacific Economic Cooperation (APEC), in September it will host a summit in Vladivostok. The economic liberalisation processes that are underway in the Asia-Pacific region are in line with the tendencies of the modern post-crisis global architecture.

Russia intends to take a proactive part in these processes and harmonise with its Asian counterparts. At the same time we cannot use standards that would differ from those that form the basis of the European Union and of the single economic space. These very standards should be used in the work with the Asia-Pacific partners.

I believe this is an absolutely natural process, which can lead to the formation of a true global economy because today’s global economy has formed in a rather spontaneous fashion.

Countries and their economic policies simply could not keep up with globalisation processes at the micro level, which has resulted in the formation of a global economy with global interdependence and interrelationships but without global management.

Organisations that were in charge of the global management of various spheres of this economy discovered during the crisis that they lacked sufficient authority and capacity. Among them were the International Monetary Fund and the World Trade Organisation.

Therefore, the process of regionalisation should not be deemed an alternative to globalisation.

Regionalisation means that two hundred participants in the global economy can hardly come to an agreement. However, if these two hundred participants unite into twenty teams with common interests and economic interconnection, and if these teams will together build global rules of the game in the world's economic field, this process is expected to be more systemic, more intelligible and less stressful.

For this reason I believe there are no controversies between globalisation and regional integration. They are two sides of the same coin. The process of economic integration, of which Eurasian integration is a dynamic manifestation, is one of the tools to help the global economy recover from its currently challenging condition.

I also hope that this will change the world's geography: Big Europe (from the Atlantic to the Pacific), that politicians have been talking about for a long time, will be born. Or perhaps it will be Wide Europe, from Vladivostok to Lisbon?

# 3

## Assessing the Economic Effect of Kyrgyzstan's Accession to the Customs Union

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This study was initiated by the Centre for Integration Studies of the Eurasian Development Bank (EDB) to assess the economic impact of the Kyrgyz Republic joining the contractual and legal base of the Customs Union between Kazakhstan, Russia and Belarus. The project concentrated on the applied matters of the potential Kyrgyz accession; this chapter represents a brief synopsis of the findings of this technical study<sup>1</sup>.

By various estimates, the 25-50% decline in Kyrgyzstan's GDP in the 1990s can largely be explained by the disruption of cooperative ties during the collapse of the Soviet Union. For nearly 20 years, the global competitive advantages of post-Soviet countries were underutilised, and economic cooperation between them constantly decreased. In 2003-2004, an attempt was made to change the situation by creating a Single Economic Space. However, its formation encountered a number of significant obstacles. In

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<sup>1</sup> <http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/kyrgyzstan/>



recent years, the real prerequisites for the rapid development of integration within the Eurasian Economic Community emerged. In 2010, the CU of Belarus, Kazakhstan and Russia was established. In 2012, the treaties forming the SES on the territory of these three countries came into effect.

Presumably, the accession of Kyrgyzstan to the CU would provide additional benefits to the CU and substantial economic benefits for the republic due to expansion of interstate cooperation and the related synergy. In order to promote this process, there is a need for a comprehensive assessment of long-term macroeconomic effects associated with the accession of Kyrgyzstan to the CU.

Currently, the economy of Kyrgyzstan is facing a number of significant disparities, which directly affect its competitiveness and efficiency. Formed during the Soviet period as part of the general Soviet economic system, the Kyrgyz Republic was faced with loss of capacity, even for reproduction on a simple scale, following the breakdown of economic ties.

Despite Kyrgyzstan's high degree of openness to foreign investors and its entry into the World Trade Organisation on December 20, 1998, the predicted surge in investment activity has not actually occurred. The major obstacles are the lack of natural resources and competitive industry, and the low capacity of the domestic market. The hydropower sector of the economy may still possess a certain appeal, but its development depends on cooperation between Central Asian countries, which is lacking.

Kyrgyzstan's main purpose of joining the WTO was to increase the volume of the country's foreign trade, and therefore enhance the level of economic development. However, the effects of such a step are hard to evaluate and much less predict. For example, the most significant achievement of foreign trade policy liberalisation is considered to be the openness of the economy, which, on the one hand, presupposes the development of joint ventures, the abolition of state monopoly of foreign trade, the effective use of comparative advantages in the international division of labour, greater specialisation and cooperation in production, rational allocation of resources, and increased competition between domestic producers. On the other hand, open economy requires reasonable access to the domestic market for foreign capital, goods, technology, media and labour. If these conditions are not met, then the spontaneous opening of the economy can have a negative impact on economic development, by creating an unsustainable structure of exports and imports, which pulls the economy into an unequal exchange in foreign trade.

Upon entry into the WTO, Kyrgyzstan made many concessions and commitments that were even not expressly required by the organisation. In particular, the country committed itself to adhere to virtually all non-binding agreements and sector initiatives of the WTO member countries (for example, agreements on tariff concessions with respect to chemical and pharmaceutical products,

textiles, steel, nonferrous metals, research, agricultural equipment, furniture, paper, and several other categories of product). This limited the possibility of protection for its agricultural sector and opened up almost all consumer services to non-residents. In addition, Kyrgyzstan has committed itself to joining the WTO agreement on government procurement, and some other optional WTO-related arrangements.

As a result, Kyrgyzstan received preferential treatment for its goods in trade with more than 140 countries of the WTO, which theoretically expanded the market. However, such trade preferences are beneficial primarily for finished products. Creating equal conditions for domestic and imported goods in the domestic market actually had a negative impact on the development of industry in Kyrgyzstan. The openness of the country's agricultural market to foreign producers has also adversely affected the insufficiently competitive local producers.

For more than half of commonly traded commodities, Kyrgyzstan has established rates of import customs duties lower than those that are expected to be agreed upon within the WTO-related agreements of the CU member states. The main objectives pursued by Kyrgyzstan when joining the WTO – developing export potential, enhancing the competitiveness of domestic producers, and improving the country's structure of production and position in the international division of labour – have not been achieved so far. The country cannot effectively take advantage of the preferential conditions offered by WTO members, since most of its exports, especially in manufacturing, are not competitive.

When joining the WTO, Kyrgyzstan assumed that local businesses would evolve and integrate into global technological chains, but in practice this has not happened. Even the export of raw materials, primarily antimony, tin and rare earth elements, is not competitive because of the high cost when compared to neighbouring China, where these products are cheaper.

It should be noted that contemporary multinational companies have sufficient capacity to provide the necessary industrial cooperation in certain areas, even without participation in the WTO. Even before Kyrgyzstan's entry into the WTO, Kyrgyz enterprises that matched the requirements of multinational companies were acquired and incorporated into their structures, for example, the gold mining companies in the Kumtor region.

One reason for Kyrgyzstan's entry to the WTO was belief in the inevitable increase in investment by creating a transparent economic environment, complying with global trade rules, and participating in the global trading system. However, the authorities did not take into account that developing countries have traditionally been perceived as places with limited opportunities for investment. Economic theory suggests that a country with a relatively unfavourable investment climate would receive foreign investment only insofar

as it is closed for the imports of foreign goods. The case of imports-open Kyrgyzstan confirms the economic theory assumption.

One possible domain for investment and cooperation is the country's fuel and energy complex by way of utilising Kyrgyzstan's transit potential. The extent of investment in Kyrgyzstan could substantially increase in the event of cooperation in the sphere of hydropower.

As a WTO member, Kyrgyzstan enjoys the most favoured nation regime with all the member states of the organisation. A free trade regime has also been established with the CU countries and some CIS countries. By joining the CU, Kyrgyzstan is expected to unify its trade regulations in accordance with those established by the CU member states for trade with third countries.

Currently, the united delegation of Belarus, Kazakhstan and Russia that is conducting negotiations on joining the WTO is also in talks on free trade agreements with a number of individual countries (New Zealand, Vietnam), and with the European Free Trade Association (EFTA) that unites Liechtenstein, Iceland, Norway, and Switzerland. The delegation has also completed negotiations with Serbia and has enacted an agreement with Montenegro. Upon Kyrgyzstan's accession to the CU, it will have to sign the same agreements with those countries with similar exclusions, which may lead to the need to revise Kyrgyzstan's WTO commitments. The CU member states, as well as Kyrgyzstan, have preferential treatment with many other countries. The unification of Kyrgyzstan's regulations should take place through the adoption of the CU's legal standards, which will affect its international obligations with regard to WTO member states.

The formation of regional unions is allowed within the WTO (Article 24 of the General Agreement on Tariffs and Trade, or GATT). In addition, Kyrgyzstan has the right to initiate secondary negotiations on altering its commitments on tariffs (Article 28 of GATT). Negotiations with the WTO may pertain to compensation conditions or reduction of import duties on other goods. Every three years, Kyrgyzstan has the right to make changes in its list of commitments on tariffs for the next three-year period. The last period of exercise of this right covers up to December 31, 2011. Thus, Kyrgyzstan may make alterations in its WTO-related commitments in favour of the CU.

The CU's legislation allows membership in the WTO. Analysis of the protocol on Kyrgyzstan's accession to the WTO reveals that the republic's international obligations and legislation differ from the legal framework of the CU and SES, providing much less protection for the Kyrgyz domestic market. In particular, this applies to the Customs Tariff of the Kyrgyz Republic (CT), which should be altered to be aligned with the CU Common Customs Tariff (CU CCT).

When the Customs Tariffs of Kyrgyzstan and the CU are compared, it can be seen that of 10,968 Kyrgyzstan's duty rates 3,288 (30%) concur with and

**Table 3.1.**  
Comparative analysis of the CU CCT and Kyrgyzstan's CT

CU FEACN* Groups	CU CCT Average Rate (%)	CT Average Rate (%)	Average Rate Differences	Total number of CCT rates	Total number of CT rates	Number- of-rates differences	Rate concurrences	Unification levels (%)	Average Difference (%)
1	5.94	0	5.94	69	69	0	22	31.9	5.94
2	40.49	10	30.49	396	392	4	0	0	31.35
3	10.04	10	0.04	345	344	1	324	94.2	0.04
4	16.18	10.15	6.03	178	239	61	14	5.9	5.25
5	7.58	7.81	-0.24	33	32	1	13	40.6	-0.16
6	11.75	5.25	6.5	40	40	0	0	0	6.5
7	14.39	13.05	1.34	123	123	0	71	57.7	1.87
8	6.86	6.19	0.68	123	122	1	60	49.2	0.85
9	6.09	5.82	0.27	55	55	0	18	32.7	0.27
10	4.35	6.84	-2.49	57	57	0	7	12.3	2.61
11	10.26	9.88	0.38	82	82	0	67	81.7	0.77
12	4.45	0	4.45	73	73	0	8	11	4.45
13	5	5	0	13	13	0	13	100	0
14	13	8	5	5	5	0	0	0	5
15	10.35	9.54	0.82	146	140	6	49	35	1.32
16	20.1	9.95	10.16	96	96	0	0	0	10.16
17	10.71	4.87	5.84	100	77	23	22	28.6	6
18	12.88	4.83	8.06	29	29	0	6	20.7	8.08
19	14.8	10.29	4.51	51	51	0	5	9.8	4.5
20	13.47	14.79	-1.32	347	338	9	47	13.9	-1.36
21	15.96	6.92	9.05	60	60	0	0	0	9.04

CU FEACN* Groups	CU CCT Average Rate (%)	CT Average Rate (%)	Average Rate Differences	Total number of CCT rates	Total number of CT rates	Number- of-rates differences	Rate concurrences	Unification levels (%)	Average Difference (%)
22	19.13	4.43	14.7	185	185	0	5	2.7	10.26
23	7.65	3.64	4.02	66	66	0	35	53	4.02
24	10.48	3.87	6.61	31	31	0	1	3.2	6.61
25	5.01	3.97	1.05	87	87	0	56	64.4	1.05
26	3.82	4.8	-0.98	51	51	0	39	76.5	-0.98
27	4.8	3.65	1.15	120	111	9	78	70.3	1.26
28	5.12	4.65	0.47	255	255	0	218	85.5	0.49
29	4.73	4.13	0.6	545	545	0	472	86.6	0.61
30	8.23	0	8.23	79	79	0	13	16.5	8.35
31	10	0	10	34	34	0	0	0	10
32	4.34	0	4.34	68	64	4	10	15.6	4.61
33	9.02	0	9.02	51	49	2	1	2	9.18
34	12.16	0	12.16	37	36	1	0	0	12.5
35	6.29	0	6.29	35	35	0	0	0	6.29
36	17.5	3.5	14	12	10	2	0	0	16.5
37	6.64	0	6.64	58	58	0	3	5.2	6.64
38	5.95	0.27	5.68	147	146	1	3	2.1	5.72
39	10.13	0	10.13	271	264	7	10	3.8	10.26
40	7.23	4.25	2.98	110	106	4	17	16	3.16
41	3.38	0	3.38	77	77	0	25	32.5	3.38
42	16.45	8.95	7.5	38	38	0	0	0	7.5

CU FEACN* Groups	CU CCT Average Rate (%)	CT Average Rate (%)	Average Rate Differences	Total number of CCT rates	Total number of CT rates	Number- of-rates differences	Rate concurrences	Unification levels (%)	Average Difference (%)
43	9.17	1.19	7.97	109	109	0	1	0.9	7.96
44	15	0	15	188	186	2	0	0	15.05
45	5	0	5	12	12	0	0	0	5
46	15	0	15	24	24	0	0	0	15
47	7.4	0	7.4	26	26	0	0	0	7.4
48	13.43	0	13.43	185	183	2	0	0	13.46
49	6.35	0	6.35	26	26	0	15	57.7	6.35
50	4.8	5	-0.2	25	25	0	24	96	-0.2
51	8.29	5.79	2.5	70	70	0	25	35.7	2.5
52	11.01	6.15	4.86	148	148	0	6	4.1	4.86
53	7.84	4.86	2.97	37	37	0	25	67.6	2.97
54	9.2	4.43	4.77	88	88	0	29	33	4.77
55	7.95	5.35	2.6	144	144	0	77	53.5	2.6
56	8.46	3.73	4.73	65	67	2	38	56.7	4.69
57	20	10	10	37	37	0	0	0	10
58	15	9.63	5.37	54	54	0	0	0	5.37
59	6.63	4.65	1.98	43	43	0	26	60.5	1.98
60	10	10	0	56	56	0	56	100	0
61	10.75	10.86	-0.11	147	147	0	0	0	-0.11
62	10	11.96	-1.96	190	191	1	0	0	-1.96
63	18.89	10.79	8.1	81	81	0	0	0	8.1

CU FEACN* Groups	CU CCT Average Rate (%)	CT Average Rate (%)	Average Rate Differences	Total number of CCT rates	Total number of CT rates	Number- of-rates differences	Rate concurrences	Unification levels (%)	Average Difference (%)
64	8.6	9.1	-0.5	82	122	40	11	9	-0.04
65	10	10	0	22	22	0	14	63.6	0
66	15	10	5	9	9	0	0	0	5
67	10	10	0	8	8	0	6	75	0
68	14.61	6.67	7.94	76	75	1	2	2.7	8.13
69	16.83	9.23	7.6	52	52	0	0	0	7.60
70	13.63	8.31	5.32	142	142	0	5	3.5	5.38
71	18.12	9.84	8.27	64	64	0	4	6.3	8.33
72	5.41	0	5.41	363	342	21	17	5	5.72
73	13.67	0	13.67	339	313	26	7	2.2	14.74
74	4.92	0	4.92	63	63	0	3	4.8	4.92
75	7.92	0	7.92	24	18	6	0	0	10
76	12.16	0	12.16	73	63	10	5	7.9	14.13
78	5	0	5	11	11	0	0	0	5
79	5	0	5	11	11	0	0	0	5
80	5	0	5	5	5	0	0	0	5
81	10.81	8.27	2.55	80	75	5	0	0	3.24
82	8.03	5.28	2.75	109	108	1	31	28.7	2.82
83	14.59	8.6	5.99	51	50	1	7	14	6.28
84	3.4	2.28	1.11	1,213	1,167	46	700	60	1.19
85	7.91	3.23	4.68	724	699	25	202	28.9	4.87

CU FEACN* Groups	CU CCT Average Rate (%)	CT Average Rate (%)	Average Rate Differences	Total number of CCT rates	Total number of CT rates	Number- of-rates differences	Rate concurrences	Unification levels (%)	Average Difference (%)
86	5.94	0	5.94	45	43	2	2	4.7	6.74
87	10.84	7.92	2.92	331	274	57	36	13.1	3.74
88	12.43	2.5	9.93	33	24	9	3	12.5	11.67
89	11.18	5.13	6.05	38	38	0	17	44.7	6.05
90	5.13	1.69	3.44	296	284	12	124	43.7	3.69
91	16.32	8.57	7.74	57	56	1	4	7.1	7.68
92	7.86	6.79	1.07	28	28	0	18	64.3	1.07
93	20	0	20	27	27	0	0	0	20
94	13.62	2.43	11.18	115	111	4	0	0	11.57
95	12.94	5.15	7.79	68	68	0	7	10.3	7.79
96	14.29	9.72	4.57	71	71	0	4	5.6	4.57
97	0	2.86	-2.86	7	7	0	5	71.4	-2.86
	10.35	4.87	5.49	11,170	10,968	410	3,288	29.4	5.67

Note: \* FEACN – Foreign Economic Activity Commodity Nomenclature

\* The mean difference is a percentage to which an average group rate should be adjusted, to coincide with a corresponding CU CCT rate.

The data in Table 3.1 gives only an idea of average values within Commodity Code groups due to round-offs and multiple changes in a number of CU CCT duty rates in the process of preparation for this study



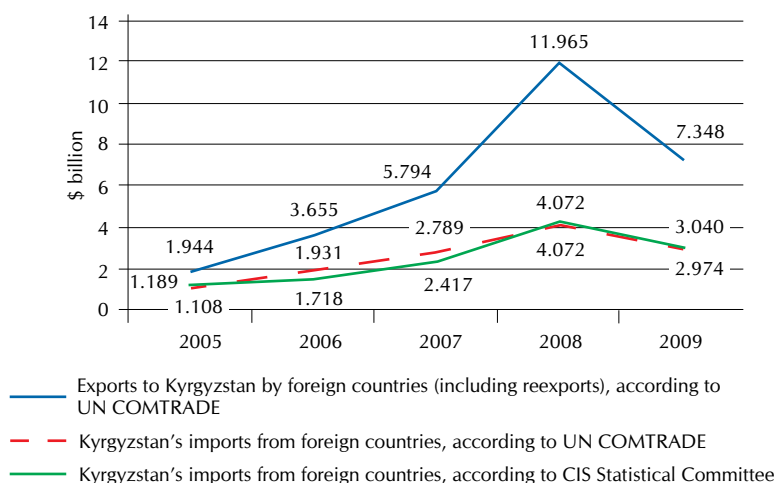
another 2,284 (21%) can be realigned with the CU CCT without violating WTO commitments. However, 4,696 (46.6%) of Kyrgyzstan's customs duties do not tally with the CU CCT, while 241 (2%) are incomparable because of differences in duty rates categorisations.

The average rate of the CU CCT is about 10.5%, while the average rate of Kyrgyzstan's CT is about 5%, and the average rate of the country's potential CT, considering its obligations to the WTO, is 7.7%. Thus, in case of enacting the CU CCT, an average increase in Kyrgyzstan's CT rates in excess of its WTO commitments will be about 3%.

If Kyrgyzstan initiates negotiations to modify its WTO commitments at present, it would have to make changes on a substantial number of rates (around 5,000). When all CU countries accede to the WTO, Kyrgyzstan would have far fewer duty rates to modify.

Based on the average 3% increase in import duties in excess of Kyrgyzstan's WTO commitments, possible claims of WTO member states may result in worsening terms of trade, estimated in the range from \$40 to \$180 million annually. However, such claims may be settled due to certain concessions in respect of specific CU CCT sub-positions within the framework of the CU united negotiating delegation.

Foremost, the changes in import duty rates will affect the country's trade with China, imports from which in 2009, according to Kyrgyzstan, totalled \$0.6 billion (20% of total imports and 47% of Kyrgyzstan's imports from non-CIS countries), and according to UN COMTRADE – \$5.2 billion (71% of Kyrgyzstan's total imports or 89% of imports from non-CIS countries). It should be noted that, according to some estimates, the main flow of goods from China to Kyrgyzstan



**Figure 3.1.**  
Dynamics of  
Kyrgyzstan's foreign  
trade in 2005-2009  
(\$ billion)

comprises goods that are delivered subsequently onto the CU territory, due to lack of appropriate control.

The data shown differs by two to three times, which may indicate the unreliability of Kyrgyzstan's official statistics. The differences give rise to significant discrepancies in estimating Kyrgyzstan's share in the CU imports.

It must be borne in mind that the data is obtained using "mirror statistics", in which the volume of imports into a country is taken as the total exports to it from other countries. The results may not always be quite correct, since the foreign trade data provided to UN COMTRADE is based on the countries' specific methodologies of foreign trade statistics.

Currently, Kyrgyzstan does not apply any special protective, antidumping or countervailing measures against third countries. If it joins the CU, the CU protective measures would be valid for it. In this case Kyrgyzstan will have to define which measures would be applied and which would not.

Market access policies of Kyrgyzstan and the three CU and SES member states differ significantly. For example, access to transportation via pipelines, road and railway transportation services, and other services is unrestricted for WTO member states in Kyrgyzstan.

Another difference from the established SES agreements is Kyrgyzstan's commitments on WTO-related subsidies. Thus, in accordance with Article 6.4 (a) of the WTO Agreement on Agriculture, Kyrgyzstan adopted a minimum rate of subsidy based on the average subsidy rate for particular products in 1994–1996, which is less than 5% of production costs of each subsidised commodity, and an average level of subsidy for all commodities, which is less than 5% of the overall agricultural production. That is significantly lower than the level of subsidies defined by the SES agreement (10%), as well as the commitments agreed upon by Russia and Kazakhstan in their negotiations on the accession to the WTO.

The following should be noted with regard to predicted growth in Kyrgyzstan's budget revenues from levy of customs duties. Kyrgyzstan currently uses a simplified procedure for customs clearance of goods from China and applies tariffs by weight for almost the entire FEACN range of products (up to 2011 – \$0.15, from 2011 – \$0.2 per kg of goods imported by land). The importer states the cost of goods arbitrarily, which in turn, can seriously distort the customs value of goods as the customs service does not have to determine the accurate value of imported goods to collect revenue. With Kyrgyzstan's accession to the CU, this procedure will have to be cancelled and brought in line with the customs procedures and methodology of the CU.

Upon Kyrgyzstan's accession to the CU, the national budget revenues from customs duties will be determined by the standard allocations of import duties

to be credited to the budget as a share of the total volume of the CU's import duties.

According to preliminary expert estimates, this share could vary from 0.62% to 0.73% with no significant exemptions from CU CCT. Based on the revenue import duties of the CU for the first quarter of 2011, which amounted to about \$5.5 billion, Kyrgyzstan's share (0.65%) for the first quarter of 2011 could reach \$35.6 million, respectively, and for the year – \$142.6 million.

In 2010, the actual budget revenues from customs duties in Kyrgyzstan amounted to \$100.5 million. Thus, by this alone, the country could increase revenue by about 42%, or about 3% of its total revenue budget in 2010. As part of the national budget revenue from VAT, the impact of the country's accession to the CU is assessed as neutral and would depend on the total amount of added value created in Kyrgyzstan.

Kyrgyzstan's budget revenues in 2010	million som	\$ million	Share in total income (%)
Tax revenues, including:	39,365	916.3	68.6
related to the import of goods, including:	14,685.6	341.8	25.6
VAT on goods imported into Kyrgyzstan	10,370	241.4	18.1
Customs duties from imported goods	4,315.6	100.5	7.5
Other tax revenues	24,679.4	574.5	43
Transfers from abroad	7,022	163.5	12.2
Non-tax revenues	10,997.3	256	19.2
<b>Total</b>	<b>57,384.5</b>	<b>1,335.8</b>	<b>100</b>

**Table 3.2.**  
**The structure of Kyrgyzstan's state budget revenues in 2010**

*Note:* The average exchange rate in 2010 was 42.96 soms per 1\$

The main risks of Kyrgyzstan's accession to the CU relate primarily to a possible decrease in imports due to the cancellation of the simplified declaration procedure, which may result in the loss of Kyrgyzstan's attractiveness for Chinese imports for subsequent reexport to other countries. This could cause an increase in unemployment among the population in the sector involved and so reduce income from taxation, but would not affect the distribution of the share of import duties of the CU, since normative distribution is calculated based on the imports in previous years.

Another problem is the inadequacy of the methodology used to calculate the normative distribution of import duties. The CU states' methodology is based on actual import figure, which is close to the amount consumed. In the case of Kyrgyzstan, the value of consumed imports is lower than the total value of imports, since many goods are reexported to other CIS countries, including the territory of the CU. It is therefore important to clarify the methodology for calculating normative distribution of import duties for Kyrgyzstan.

As far as tariff preferences on payment of customs duties are concerned, the principles of their provision in Kyrgyzstan differ from those set forth in the CU. For example, the legal framework of the CU, in contrast to Kyrgyzstan, defines the list of products from developing countries – a single-user system of the CU preferences on the import tariffs rates set at 75% of import tariff rates of the CU CCT. Upon accession to the CU, Kyrgyzstan should adopt regulations, operative under a unified system of tariff preferences of the CU, including rules concerning the goods originating from developing and least developed countries.

Entry to the CU involves Kyrgyzstan joining all agreements included on the list of international treaties that constitutes the CU legal framework. Moreover, all the relevant decisions of the EurAsEC Interstate Council and the Customs Union Commission shall be binding for Kyrgyzstan.

Increased tariffs, strengthened customs controls and cancellation of a simplified clearance procedure for imports may lead to an increase in Kyrgyzstan's domestic market prices. Given that a one-off increase in tariffs is inevitable when the CU CCT is introduced, the consumer price index is projected to jump by about 2%.

It should be noted that collection of duties from Chinese imports at the rates set by the CU CCT will inevitably lead to a decrease in volume due to the partial redirection of imports to other countries in the CU, bypassing Kyrgyzstan. However, it will create additional incentives for investment in Kyrgyzstan in order to establish production of the relevant goods in the country itself.

If Kyrgyzstan does not join the CU in the immediate future, it would worsen the country's current economic situation due to the increased control on the external borders of the CU, and deprive it of potential prospects for economic development, because the low capacity of Kyrgyzstan's domestic market can hardly be seen as appealing for domestic-market-bound investment.

Joining the CU may have a positive impact on Kyrgyzstan's production and export of agricultural products, textiles, and building materials, as these products will become more competitive than similar products from China due to higher import tariffs set in accordance with the CU CCT, and as a result will earn a bigger market share in the CU. This will mitigate the risk and increase the predictability of long-term investment in Kyrgyzstan, particularly in the electricity and transport sectors, since economic relations in those sectors will be largely regulated at the level of the SES.

The negative consequences in the short term may include a loss of attractiveness of Kyrgyzstan as a base for reexport of Chinese goods into the CU and a decrease in the flow of goods through its territory, with the corresponding loss of jobs in that sector. The rise in prices of imported goods is expected due to the application of the CU CCT rates; however, it may result in the growing

trade deficits. The probability of such developments is very high, regardless of Kyrgyzstan's accession to the CU.

This accession is not likely to significantly affect the overall macroeconomic indicators of the CU member states, given the low share of the Kyrgyz economy in the general economic indicators of the EurAsEC countries. However, a positive effect for the CU may be the improvement of customs administration on the Kyrgyz-Chinese border and the application of the CU CCT to imports from China. This will reduce the volume of cheap imports that flow through the republic onto the territory of the CU, and improve the overall quality of imports due to the need for adequate sanitary, veterinary, phytosanitary and technical control in order to comply with the legal and regulatory framework of the CU. This will improve the price competitiveness of the CU producers against the Chinese.

Joining the CU would have positive long-term economic effects for the economy of Kyrgyzstan. Integration into this large regional economic entity would lead to an expansion of markets for goods produced in Kyrgyzstan. It will increase the country's investment appeal in a number of production sectors, leading to the growth of GDP and increased exports of domestically produced goods. In general, adherence to the CU may result (if appropriate measures are taken) in a 20-22% increase in Kyrgyzstan's export potential.

It should be noted that a number of the potentially positive and negative effects of Kyrgyzstan joining the CU lie in the non-economic dimension, and are therefore outside the scope of this work.

According to the study, we can conclude that the accession of Kyrgyzstan to the CU could potentially have a positive economic effect, but its achievement depends not only upon trade but also on Kyrgyzstan's general economic policies, as well as those of the CU and SES member states.

# 4

## Commentary on the article: Assessing the Economic Effect of Kyrgyzstan's Accession to the Customs Union

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In his article, the author analyses the foreign trade ties of Kyrgyzstan (based on the research conducted by the Russian Academy of Sciences' (RAS) National Development Institute for the EDB Centre for Integration Studies) which have formed due to the country's membership of the World Trade Organisation, and the prospects for their advancement if Kyrgyzstan joins the Customs Union of Belarus, Kazakhstan and Russia. The author believes that Kyrgyzstan's economic problems, such as underdeveloped competition and low economic efficiency, prevent the country from using the full potential of free trade in the framework of the WTO. The author believes that Kyrgyzstan's accession to the CU, given the existing economic ties between its member states, would have a positive economic effect on Kyrgyzstan and the CU member states. The article provides a detailed analysis of the technical compatibility between the obligations Kyrgyzstan has undertaken in the framework of the WTO and its new obligations if it joins the CU, and identifies the issues that would require special attention in the course of negotiations between Kyrgyzstan and the WTO. In the author's opinion, the effect of the CU on Kyrgyzstan's economy will be bivalent, especially in the short term, as it could cause a rise in prices through increased customs duties, tougher customs

control and a reduction in Chinese imports and, possibly, employment in this segment. At the same time, it should have a positive effect on budget revenues. In the long term, membership in the CU could allow Kyrgyzstan to refocus its economy on production with the help of new investments, market expansion and other improved conditions.

In their 2011 study, *Economic Effects of Kyrgyzstan's Accession to the Customs Union of Belarus, Kazakhstan and Russia* for the Kyrgyz National Institute of Strategic Studies, Faruk Ulgen and Haluk Levent came to the conclusion that Kyrgyzstan joining the CU would have a positive effect. The study analyses the effects of trade creation and trade diversion in Kyrgyzstan's trade records with China and other countries from 2008 to 2010. A trade diversion will take place if the CU countries promote trade inside the union, even if their production is less efficient compared to proposals by other countries. In this instance, the volumes of trade can decrease because of protective measures against the rest of the world and this would affect the welfare of the member countries and the global trade as a whole. However, if external trade barriers are not too high and the CU increases trade through the expansion of markets and larger investments, this can lead to increased revenues, which in their turn will improve the demand for imports from non-member countries.

The authors have also studied the interrelation between trade creation as a result of joining the CU and the growth in employment. An estimate of dynamic panel data used in this analysis has shown that, in a 95% confidence interval, a 1% increase in production will cause a 0.295% growth in employment in Kyrgyzstan's economy. Despite the fact that the change in the CU tariffs for third countries such as China can reduce multilateral trade, Ulgen and Levent believe that the reduction in trade will not be significant and can result in increased domestic production. This can happen if a portion of the reduction in trade is compensated by broader trade with the CU and increased domestic production. The authors believe that production could grow by 8.8% and employment by about 2.5% after Kyrgyzstan joins the CU, as a result of net trade creation.

The authors have also calculated the trade specialisation index (TSI) and the bilateral revealed comparative advantage index (BRCA) to find out how the Kyrgyz economy relates to its main trade partners: China, Kazakhstan and Russia. These calculations have shown that in 2008–2010, Kyrgyzstan traded significantly more product categories with Russia and Kazakhstan than with China, which is why its trade with the former two countries has a comparative advantage<sup>2</sup>.

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<sup>2</sup> In the period under consideration Kyrgyzstan had two product categories in which it traded with China, twelve with Kazakhstan and three with Russia, with a TSI of 1. In the same period Kyrgyzstan had nine, 30 and 22 product categories, with a TSI between 0 and 1, with China, Kazakhstan and Russia respectively. In addition, in the same period Kyrgyzstan had 26 product categories above 84 with a BRCA of more than 1 in its trade with China, 49 with Kazakhstan, and 33 with Russia.

Even in Soviet times, Kyrgyzstan was highly dependent on imports and subsidies from the central budget. Over twenty years of sovereignty, it has not succeeded a lot in improving structural imbalances, but the accession to the WTO has given impetus to the development of an economy orientated on trade and reexport. Today the Kyrgyz economy, with its poor diversification and no scale effect, can hardly surpass the threshold of \$5 million, even at the generalised, two-digit level of trade classification; hence its strong dependence on partnering countries with a diversified structure of exports. In addition, high interest rates and economic and political risks explain the low level of investments in production and agriculture. Accordingly, the most developed sectors are the services and retailing sectors as they ensure quick profit, do not require large investments, and are flexible with respect to changes in the external environment.

The studies have shown that Kyrgyzstan's accession to the CU should entail a number of positive changes. These will include the recovery of trade ties, easier access to main markets, possible increases in investment flows to the country, and the advancement of production and agriculture. The authors agree that hydropower, textiles and agriculture will be the priority sectors, in particular because Kyrgyzstan's supply to global markets in recent years was primarily composed of textile and agricultural products.

The development of industrial production and agriculture is impeded by the economy's poor ability to compete with Chinese imports. Because of the WTO membership (and beneficial tax treatment and customs duties that depend not on the customs cost of goods but on their weight) Kyrgyzstan has spotted a niche of a reexporting economy in the CIS. In 2010, the reexport of Chinese goods exceeded 13% of the country's Gross Domestic Product (GDP). Large platforms of international trade have formed in the country, such as Dordoy and Kara-Suu where, according to the World Bank (2009), the aggregate annual sales approximate \$3.5 billion and employment exceeds 70,000 people. Since 2010 (according to the administration of the Dordoy Bazaar), wholesale volumes have gone down but retailing has seemed to grow (in small batches of approximately up to 50 kg per person after the creation of the CU in 2010).

The administration of the Dordoy Bazaar and representatives of the association of bazaars are obviously concerned about how Kyrgyzstan's possible accession to the CU will influence employment in the market. However, on the whole they understand that the creation of the CU and the Single Economic Space will result in a reduction in Kyrgyzstan's reexporting activities irrespective of whether it joins the CU or not. In the former instance, access to the main directions of reexport will be complicated and in the latter one, the transition of goods through Kyrgyzstan will become meaningless. In addition, the continuous appreciation of the Chinese yuan against the US dollar and the currencies of the region makes Chinese goods increasingly expensive. This makes it clear that



the desire to preserve the existing reexporting scheme, which has become a source of income for many people in recent years, should not be an argument in refusing to join the CU. Therefore, representatives of the markets have agreed to gradually reorientate toward production with the active support from the Kyrgyz Government, which needs to smoothly reform the markets and preserve, at least for some time, beneficial conditions for importing goods such as textiles.

Kyrgyzstan's accession to the CU will definitely change the existing economic context and this will require the adoption of correct key decisions to avoid weakening the economic situation further. The undertaken studies are the first step in this area, which requires additional research with respect to Kyrgyzstan joining the SES, including issues such as labour migration and the quality and focus of Kyrgyzstan's educational system (since the development of new sectors requires qualified specialists). Another important issue that needs to be thoroughly studied is Kyrgyzstan's shadow economy – primarily in the agricultural, trade and textile sectors. While the shadow economy accounts for 20% (according to official data), international organisations and independent experts suppose it to exceed 60%. In this situation we lack information on the real size of Kyrgyzstan's economy, which complicates economic analysis and decision making. For this reason it is deemed advisable to develop and introduce a methodology for determining the size of the shadow economy before calculating the economic effects of joining the CU.

The growing number of preferential trade agreements in the world suggests that, in spite of the platform offered by the WTO, regional trade agreements seem to take prevalence over multilateral relationships in the framework of the WTO. This is possibly caused by the fact that the CU offers wider opportunities for integration, which is specifically important to countries with close historical, political and economic ties.

# 5

## Eurasia and Eurasian Integration: Beyond the Post-Soviet Borders

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‘Eurasia’ seems to be a relatively clear concept in terms of physical geography, but much less so for social sciences. While the word ‘Eurasia’ is constantly used in various contexts (more today than twenty years ago), the specific notion of what it actually means is unclear. According to Laruele (2008), the term ‘Eurasian’ was actually invented in the 19<sup>th</sup> century to refer to children of mixed European-Asian couples, and it was later used to highlight the geological unity of the continent. Throughout the last two decades, ‘Eurasia’ has been used more commonly by both scholars and practitioners, but the definition of the term remained unclear. It goes even to a greater extent for the concept of ‘Eurasian integration’ – which is, in fact, what this yearbook (and the companion Journal of Eurasian Economic Integration, which is published in Russian) is devoted to. This paper intends to elaborate on the concept of Eurasia and Eurasian integration, distinguishing between three notions of ‘Eurasia’ and corresponding views of Eurasian integration, considering their importance in the literature and possible research developments. The ideas presented in this paper heavily draw from the discussion in our book, published in English (Vinokurov and Libman, 2012a) and in Russian (Vinokurov and Libman, 2012b).

### THREE CONCEPTS OF EURASIA

#### Post-Soviet Eurasia

The first and probably the most often cited concept of Eurasia is also the youngest one: it came into existence in December 1991, when the Soviet Union ceased to exist. While originally the former Soviet republics have been naturally described as ‘post-Soviet’ or ‘post-Communist’ (also terms like ‘new independent states’ or – in Russia – the ‘near abroad’ were used), over time using this term became less and less reasonable: defining a group of countries only through their common historical past, even if the latter is highly important, is a questionable approach. In fact, more and more voices (as early as Carothers 2002) call for an abandonment of the transition paradigm in investigating the post-Soviet space. However, in spite of the changes within the two decades following the collapse of the USSR, there is still a lot of work focusing on these countries as a comparable group: Frye (2012) in his recent survey even suggests that these countries become more important for investigations of political and economic institutions.

There are three reasons why the post-Soviet countries are considered as a unified entity in academia and outside it. First, they still constitute a natural group for comparison of different institutional, political and economic developments. While this view seemed to be obvious twenty years ago, today it requires justification: it is likely that, for some research questions, comparing post-Soviet countries is meaningful, while in other aspects they deviate a lot from each other (Stykow, 2012, offers an excellent discussion of the topic). Secondly, there exist intensive links between these countries, so they do influence each other strongly. Third, and finally, studying most of these

countries still requires a set of common skills: for example, knowledge of the Russian language still may suffice for a researcher dealing with these countries (although less so than twenty years ago). Since the skills of the researchers have a crucial influence on the chosen objects of investigation (Libman, 2007), this is an issue of extreme importance. Therefore, it is necessary to find a new name for the region under investigation: a natural solution chosen within academia and outside it seems to be 'Eurasia'.

The examples of how Eurasia is used as synonym for the post-Soviet space are numerous; it pops out in multiple academic articles (e.g. Bruckbauer, 1994; Fish, 1999; Beissinger and Young, 2002; Rivera, 2003; Hale, 2005; and many others – sometimes the former Eastern Europe is included in the concept of Eurasia as well). Many scholarly journals dealing with the region were renamed in a way using 'Eurasia', and new journals in the field were named applying the same word: examples include *Eurasian Geography and Economics*, *Europe-Asia Studies*, *Kritika: Explorations in Russian and Eurasian History*, *Eurasian Review* and *Journal of Eurasian Studies* outside the region and *Russia and New States of Eurasia* (published by the Institute of World Economy and International Relations of the Russian Academy of Sciences), *Eurasian Economic Integration* (published by the Eurasian Development Bank) and *Eurasian Integration: Economy, Law, Politics* (published by the Interparliamentary Assembly of the Eurasian Economic Community). Numerous research centres were renamed in the same way in Harvard (Davis Centre for Russian and Eurasian Studies), Columbia (Harriman Institute: Russian, Eurasian and Eastern European Studies), Berkeley (Institute of Slavic, East European and Eurasian Studies), Stanford (Centre for Russian, East European and Eurasian Studies), Illinois Champaign-Urbana (Russian, East European and Eurasian Centre), Toronto (Centre for European, Russian and Eurasian Studies), Leuven (Russia and Eurasia Research Group), Oxford (Russian and Eurasian Centre), Uppsala (Department of Eurasian Studies) and Cambridge (Eurasia Centre at the business school). The name of the leading American scholarly society dealing with the region was changed to The Association for Slavic, East European and Eurasian Studies, and the International Council of Central and East European Studies, although it did not change its name, devoted its world congress in 2010 to the topic of Eurasia.

Outside academia, those regional organisations created by post-Soviet states from the early 2000s onwards also tend to use the word 'Eurasia' more and more often. Again, it is hardly surprising: the early titles like the 'Commonwealth of Independent States' did not provide any reference to a particular region or even any common feature of the member states (in fact, the titles stressed only the fact that they were 'independent' of each other). The most notable examples are the Eurasian Economic Community and the Eurasian Development Bank. However, the idea to use the word 'Eurasian' to describe these countries is older than the last decade – Andrei Sakharov's project of the Soviet Union

new constitution intended to rename it into a ‘Union of Soviet Republics of Europe and Asia’; and Nursultan Nazarbayev’s initiative to create a more advanced regional organisation for the post-Soviet space in early 1990s called it the ‘Eurasian Union’. Outsiders also seem to ‘naturally’ call the region ‘Eurasia’: e.g. the ‘European and Eurasian’ bureau at the US State Department. The word ‘Eurasia’ (including post-Soviet states) found its way into definitions of regions used by many businesses (e.g. Nordic Investment Bank).

Strictly speaking, the ‘post-Soviet Eurasia’ is, unlike another concept of Eurasia, which we are going to present below, free from any ideological connotations. It is merely a designation of a particular region, chosen for the lack of better words to describe it. However, it still relies on a debatable assumption: it claims that the post-Soviet space is going to stay a relatively interconnected entity and that the countries comprising this region will be relatively comparable to each other. Whether this is indeed the case is debatable; while some researchers point out that the countries of the region still strongly depend on each other (Buzan and Waeber, 2003), others, on the contrary, proclaim the ‘End of Eurasia’ (Trenin, 2002; 2011; Tsygankov, 2012). Typically, in this case it is assumed that the pre-Soviet legacies of the individual parts of the post-Soviet world are going to dominate and eventually lead the countries on very different paths. As one could probably expect, the reality in the post-Soviet region is more complex than any of these views: while in some cases ‘Eurasia’ seems to dissipate, in other areas integration becomes stronger.

### **Eurasianism**

The second concept of Eurasia is much older than the collapse of the Soviet Union and can be traced back to the 1920s Russian emigrants, promoting the ideas of ‘Eurasianism’. Unlike the post-Soviet Eurasia, the concept of Eurasia in Eurasianism has a clear ideological connotation: it represents the ‘Eurasian’ world as a distinct reality from the European ‘Western’ civilisation, but also from the Asian cultures. While the last contradiction is typically not pointed out, the first one constitutes the main element of Eurasianism in many (though not all) of its varieties, which came into existence during the last hundred years. Somewhat simplified (and without attempting to provide a detailed analysis of Eurasianist ideology, which has been discussed e.g. by Laurelle, 2008), it is possible to distinguish among several variants of the ‘Eurasian space’ as defined by the ‘Eurasianists’. First, Eurasia can be perceived as a unity of the Russian-Slavic culture and the nomadic cultures of the Inner Asia (this would probably be primarily the Eurasia of Gumilev). Second, Eurasia can be viewed as a unity of Russian Orthodox and Islamic peoples. Third, the focus can be made on connections between Russian and Asian cultures. Fourth, Eurasia can be viewed as a unity of ‘continental’ countries as opposed to the Atlantist island nations (the list of which countries are ‘continental’ differs: for example,

while China is for many Eurasianists a natural continental empire, it is not the case for another famous Eurasianist, Dugin, who sees Japan and Germany as a continental nation). Fifth, Eurasia can be primarily linked to the Russia-centric Slavic-Orthodox civilisation. Sixth, it is very common among Russian scholars (especially in the International Relations) to use the word 'Eurasia' just to stress the 'geopolitical importance' of Russia (a hundred years ago, probably 'greater Russia' would be used, with this word being old-fashioned now), taking a special place of dominance among its neighboring countries. These varieties are very often combined and mixed with each other, consciously or unconsciously, and the list is certainly not exclusive.

The ideas of this 'ideological Eurasianism' are deeply rooted in the self-perception of Russian peoples (Rose and Munro, 2008) and elites. According to a survey, conducted by Russian Public Opinion Research Centre (VCIOM) in 2001, 71% of respondents said they believe Russia to be a one-of-a-kind civilisation – 'Euro-Asian or Orthodox', as it was formulated in the poll. Only 13% believed that Russia belongs to Western civilisation. To some extent, they can be perceived as a continuation of the ideas of the Russian *Sonderweg* of the nineteenth century (although many Eurasianists would probably disagree with this assessment). To some extent, the following statement of Trubetskoi (2005) seems to be an accurate description of most varieties of Russian Eurasianism: "The territory of Russia [...] constitutes a separate continent [...] which in contrast to Europe and Asia can be called Eurasia [...]. Eurasia represents an integral whole, both geographically and anthropologically [...]. By its very nature, Eurasia is historically destined to comprise a single state entity. From the beginning, the political unification of Eurasia was a historical inevitability, and the geography of Eurasia indicated the means to achieve it". In Russia and some other post-Soviet countries, some varieties of the Eurasianism enjoy the status of a recognised field in academia (e.g. the writings of Lev Gumilev) and they are present in the political arena (e.g. several 'Eurasian' parties and movements in Russia). However, Eurasianism of this sort has never been, even rhetorically, adapted as a guiding ideology of the Russian policy in the post-Soviet space or in Asia.

An interesting notion of the Eurasianists is that their picture of 'anti-Western' Eurasia seems to be accepted by some Western observers, of course, with the opposite ideological connotation: now Eurasia is treated (politically) as a zone of Russian influence and (culturally, socially and economically) as a domain of non-democratic regimes, oligarchic economies and archaic social orders. This is, for example, the picture offered in Bugajski (2008) and Ryabchuk (2001); the latter, for example, describes the modern Ukraine as a battleground between 'European' and 'Eurasian' elements. From this point of view, Eurasia can expand or shrink at its borders. However, while the word 'Eurasia' is used, it is typically 'Russia' which is in mind of the observers – as Russia has a long tradition of the *Sonderweg* thinking, Europe does have a long tradition as defining Russia

as ‘the Other’ outside of the European civilisation (e.g. Neumann, 1999). It is interesting to notice that for the people in Asia (e.g. China), Russia is unambiguously perceived as a ‘European’ country (both in positive and in negative sense; Russia also has its tradition of colonialism in Asia), different from what Eurasianists would expect.

### **Eurasia as a continent**

The third concept of Eurasia focuses on interdependencies between the European and the Asian parts of the continent. To some extent, the very approach of dividing Europe and Asia as two continents is artificial. As for Asia, as Freeman (2011) notices, “for thousands of years after strategists in Greece came up with this Eurocentric notion [of Asia – **E.V., A.L.**], the many non-European peoples who inhabited the Eurasian landmass were blissfully unaware that they were supposed to share an identity as ‘Asians’”. In the same way, Europe was constructed over millennia. However, during this period there was, as we will discuss in what follows, a vivid economic and political exchange spanning the entire Eurasian continent. The third notion of Eurasia perceives it exactly as this web of connections, which, after a period of decline over several centuries, start reviving now. As such, Eurasia naturally spans beyond the Soviet borders.

This perception of Eurasia faces serious difficulties while searching for its way in the academic literature, clouded by two previously defined concepts of Eurasia. Nevertheless, several papers describe the economic links between China and the EU (e.g. ASEM) as ‘Europe-Asian’ regionalism (see e.g. Stockhof et al., 2004; Roessler, 2009; Dent, 2003). Among other studies, the work of Johannes Linn (Linn and Tiomkin, 2006, 2007) should be emphasised, as it explicitly concentrates its attention on the emerging economic ties in the Eurasian ‘supercontinent’ (Linn, 2006).

Recently, the idea of Eurasia in this context has been picked up by several Russian observers (Bykov, 2009; Chernyshev, 2010; Krotov, 2011; Spartak, 2011), discussing the development of the post-Soviet integration. An area where the minority of Eurasia faces less difficulties is Central Asian, or (following the name of the leading scholarly association in this area in the US) Central Eurasian studies – indeed, it is difficult to study the history, the current economic development or the ethnography of the modern ‘post-Soviet’ Central Asia while simultaneously ignoring its links to Chinese Turkestan, Afghanistan and Iran (Gleason, 2003). Since the focus of this concept of Eurasia is on ties and exchange, it is less bound by ideological considerations than the Eurasianism described above – in fact, if there is a lesson to be learned from the last two millennia of Eurasian history it is that trade transcends all differences and crosses all barriers. As such, this Eurasianism can be styled as ‘pragmatic’ Eurasianism.

As such, the ‘pragmatic Eurasianism’ is entirely compatible with focus on institutional and technological transfer from the West; in the sense, it is related to what Trenin (2006) describes as the ‘new West’, that is, the modernisation and marketisation of non-Western societies following the blueprints of the West. Of course, it does not imply the unequivocal acceptance of particular institutions and practices (which also differ greatly within the group of the Western nations), yet it is very different from creating the rejection of the Western ideas and the explicit attempt to construct an alternative to them typical for many branches of the Russian ideological Eurasianism, or the view on the relations between ‘Eurasia’ and ‘the West’ as inevitably hostile and competitive.

It is likely that the country where the ideas of this pragmatic Eurasianism received the greatest recognition was Kazakhstan, where the Eurasian idea is, unlike Russia, very often recited and accepted on the level of political ideology. It is important to stress that we do not, under any conditions, claim that pragmatic Eurasianism is the ideology of Kazakhstan – what we see is rather a combination of Eurasian rhetoric (paying tribute to various branches of Eurasianism, e.g. to Lev Gumilev, and also to the idea of the ‘post-Soviet Eurasia’), nation-building effort and some elements of pragmatic Eurasianism, which are, however, stronger than in other parts of the post-Soviet space; it is rather a set of rhetorical statements and political goals than a philosophy or ideology of some kind. The Eurasian idea has a firm position in Kazakhstan, partly because

	Eurasia as the post-Soviet area	Eurasianism as ideology	Pragmatic Eurasianism
Constituent factor for Eurasia	Shadow of the Soviet past	Cultural, historical and geopolitical commonality	Emerging economic linkages
Perception of Europe	Excluded (with possible exception of post-Communist countries)	Excluded (and treated as the Other constituting Eurasia)	Included
Perception of Asia	Excluded (with possible exception of Mongolia and China)	Partly included (depending upon particular approach: China, Japan, Great Steppes)	Included
Perception of Westernisation and modernisation of Eurasia	Limited probability of the Former Soviet Union countries becoming an integral part of the Western world (therefore a long-term special designation needed)	Rejection of modernisation through Westernisation and search for ‘another way’	Learning from the West as the strategy of modernisation; limited attention to ideology and focus on economic aspects
Nature of the concept	Geographical notion, definition of an area for research, policy and business purposes	Science or ideology	Set of foreign policy or economic policy ideas without ideological pretence

**Table 5.1.**  
**Three concepts**  
**of Eurasia**

Source: Vinokurov,  
Libman 2012



of its focus on the links between Slavic and Turk cultures (e.g. the ideas of Olzhas Suleimenov), but it clearly assumes that “Eurasia is not synonymous with Russia” (quoting the famous 19<sup>th</sup> century Kazakh ethnographer Chokan Valikhanov, see Nysanbayev and Kurmanbayev, 1999). As such, Eurasianism does not serve as a Sonderweg ideology (in fact, of many alternatives available to Kazakhstan it is one of the least compatible with it) and instead concentrates on perceiving the country (as Nursultan Nazarbayev calls it) a “Eurasian bridge”. The effort of Kazakhstan to develop integration both within the post-Soviet world, with its Asian neighbors, as well as with Europe (e.g. OSCE presidency), and a widespread economic liberalisation fit under the umbrella of this notion of Eurasia.

*Table 5.1* provides a brief summary of three concepts of Eurasia discussed in this paper. Again, it is crucial to stress that three notions we describe are rather brute generalisations than descriptions of precise and well-defined intellectual positions or camps. Furthermore, it is incomplete: the ‘Eurasianism’ has its own tradition, for example, in Ukraine and in Turkey, very different from what we have described above. Yet even this simplification could form a good basis for further discussion of what ‘Eurasian integration’ is, which we will address in the next section.

## POST-SOVIET AND CONTINENTAL EURASIAN INTEGRATION

### Waves of exchange in Eurasia

Each of the concepts of Eurasia has its own distinct picture of what may be called ‘Eurasian integration’. For the post-Soviet Eurasia it is a clearly defined set of regional integration organisations created by the post-Soviet states (regionalism), as well as persistent and emerging ties between these countries (regionalisation). There exists a large amount of literature on these organisations in Russian academia, and a much smaller amount in the West (Libman, 2012), though the area as a whole remains generally under-researched (Wirminghaus, 2012). For the Eurasianism regional integration in some form is also important, although in this case the focus is rather on the possible development of Eurasian integration than on the actual regional organisations. Laruelle (2008) even describes the attention to restoring economic and political ties between former Soviet republics as one of the most attractive features of Eurasianism. Yet typically perception of regional integration in Eurasianism shares several common features: (i) regional integration ought to be Russia-centric (this is indeed true for many post-Soviet regional organisations, although even in this case Russia has been often less active in their design than some other countries like Kazakhstan or Belarus); (ii) regional integration is perceived primarily as a tool in the general confrontation between ‘Eurasia’ and ‘Europe’ and (iii) the focus is either on military and political cooperation, or at least on intergovernmental cooperation, and much less so on spontaneous economic links between countries of the region.

The third concept of Eurasia offers a distinct picture of Eurasian regional integration, which, unlike the 'post-Soviet Eurasian integration', could be called 'continental Eurasian integration'. The focus is in this case on emerging economic linkages spanning the entire Eurasian continent, and, more specifically, on economic links between individual macroregions in Eurasia. It is, indeed, interesting to notice that contrary to the expectations of the ideological Eurasianists, in Eurasia in general and in the post-Soviet space in particular, bottom-up economic integration has been substantially more successful than the top-down regionalism. From this point of view, Eurasian continental integration is, however, not a recent phenomenon: it can be embedded into the framework of the so-called Eurasian exchanges, waves of developed exchange of goods and ideas across Eurasia, which have been observed over the last two and a half millennia (Bentley, 1998), or probably even earlier – Diamond (1997) points out that the vast Eurasian landmass spread from the East to the West supported the spread of domesticated animals and plants.

It is possible to distinguish between three waves of Eurasian exchange (Gunn, 2003; Abu-Lughod, 1989; Frank, 1992; Chaudhuri, 1985). The first wave has been observed in the first to third centuries A.D., and resulted from the emergence of a set of large stable empires spanning the Eurasian continent from the Roman Empire to the Han dynasty empire. The eastern commerce of the Roman Empire flourished after Augustus primarily through two routs: sea trade with Arabia, East Africa and India, with the centre in Alexandria, and caravan trade with China through Parthia and Central Asia (Thorley, 1969). These linkages collapsed after the end of the Roman Empire. The second wave of Eurasian exchange occurred a century later, in the 11-13 centuries A.D. Unlike the first wave, this time Europe remained at the margins of the existing trade network, which mostly spanned India, China, the Byzantine Empire and the Arab world. Again, three routs came into existence. The northern route, which is often referred to as the famous Silk Route (on various points of view on this concept see Christian, 2009; Rezakhani, 2010), connected the Arab world and China through Central Asia. The middle route connected the Mediterranean region with the Indian Ocean via Baghdad and Basra. The Southern route connected Egypt through the Red Sea to the Indian Ocean. Both Central Asian and Indian Ocean trade was implemented without great powers uniting the entire territory by merchant networks – the system of free harbours in the Indian Ocean from this point of view differed greatly from the Mediterranean experience (Hourani, 1951/1995) and has had a positive impact on the contemporary development in India until the present day (Jha, 2008). The second wave culminated under the Mongol Empire, which for the first time united the Eurasian landmass and created unprecedented opportunities for exchange (Kotkin, 2007). The third wave came into existence in the 16-19 centuries and was associated with European discoveries and colonisation.

The picture of Eurasian exchanges brings conjectures that there existed an uneasy relationship between the economic exchange and political integration. In some cases, exchange was facilitated by political unity, while in others, barriers created by new empires have in fact brought the Eurasian exchange to a halt, as it happened, for example, with the continental exchange over Central Asia after the emergence of the Ottoman, the Qing and later the Russian Empires. It also demonstrates a complex interplay between the maritime and the continental routes, as well as the importance of exchange not only for purely commercial issues (although during most of the period of existence of the Eurasian exchange goods travelled farther than people, see Abu-Lughod, 1989), but also for the movement of ideas, ideologies, technologies and religions, and also diseases and pandemics; to some extent, the Black Plague, which was the most disastrous epidemiological event in the history of the Western world (but also one of the key factors pushing the essential changes in the European economy contributing to the Age of Geographic Discoveries (Findlay and O'Rourke, 2007)), was a product of facilitated exchange between the West and the East during the Mongol Empire.

### **Eurasian integration in the last decades**

While economic connections across Eurasia played a vital role for the world economy during three waves of Eurasian exchange, the situation changed dramatically in the 20<sup>th</sup> century. During the post-World War II era, the global economic integration became mostly concentrated in the Transatlantic (the economic ties between the European countries and the US, as well as within Europe) and later Transpacific (with the growth of Japan and other Asian tigers) areas. The Central Eurasia and China areas were basically cut off from the global economy, with some exceptions (for example, the growing export of Russian oil and gas to Europe since the 1970s), and India also turned to protectionist trade policies and high regulation. Thus – although to a lesser extent than, say, Sub-Saharan Africa – Central Eurasia constituted a hole in the emerging web of globalisation.

The situation changed dramatically in the last two decades due to two major trends. One is the collapse of the Soviet bloc, forcing the post-Communist countries to search for alternative paths of integration into the world economy. This, in turn, resulted in two contradicting outcomes. On the one hand, most countries of the former Soviet Union developed firm ties with extraregional partners – starting with Russia, which is in fact the post-Soviet country with the lowest level of intraregional integration (Vinokurov and Libman, 2010). In Central Asian states, for example, China became a crucial trade partner; however, at least for some of them the development of informal trade to China is rather linked to the use of these countries as gateways into the post-Soviet space. On the other hand, therefore, the post-Soviet trade ties turned out to be more resilient than expected originally (Fidrmuc and Fidrmuc, 2003). In other areas

(like migration), the post-Soviet space actually became more integrated over the last few years (Libman and Vinokurov, 2012). There also persist issues of common infrastructure, which keep the region together; thus, the development of economic ties with extraregional partners coexists with persistence of intraregional integration at least in some areas. Second, a prominent change in Eurasia in the last two decades has been the growth of China, with trade between China and Europe becoming one of the key economic links in the modern world.

Thus, Eurasian continental integration is again on the move. It is particularly pronounced in the area of trade (both formal and informal), where interregional trade ties grow faster than intraregional trade linkages. It is also present in the area of foreign direct investments (FDI), where new generation of multinationals from China and Russia become important players influencing the economic development of Eurasia. It is, however, much less successful in the area of migration, where the Eurasian continent still consists of a number of isolated areas. Two key bottlenecks in the development of the Eurasian continental integration are the lack of intergovernmental cooperation and the problems of infrastructure. It is important to understand, however, that the land connections and sea connections (and hence transoceanic and transcontinental) integration are very different in terms of the infrastructure, policy and governance. An obvious issue is that transcontinental trade inevitably crosses borders of multiple jurisdictions, which are required to show at least some level of cooperation. Furthermore, it is very often much more costly in terms of infrastructure required (railroads or roads) than the maritime trade. This infrastructure should be, once again, jointly constructed and maintained by many countries (and the associated redistributive conflicts should be resolved – what is, as for example Central Asian experience shows, a very difficult task, see Granit et al., 2012). That is why the development of the global economy mostly went along the lines of transoceanic trade in the last few centuries. There are, however, some examples of trade where transoceanic linkages have been less developed than transcontinental: examples include oil and gas, to some extent, and also illicit drug trade, which is mostly land-based. Eurasian continental integration so far has been also very much based on maritime routes (e.g. trade between China and the EU); understanding the potential of the continental infrastructure in this respect is of vital importance.

To conclude, Eurasian continental integration is a vivid process shaping the economic development of the continent. Interestingly, again, contrary to what ideological Eurasianists would expect, it is mostly market-driven – much more than integration in the EU, for example, where top-down coordination played a crucial role. However, there is also a substantial ‘shadow’ side to the regional integration in Eurasia, which, in turn, is related to two aspects. On the one hand, partly because of the fast-track development of Eurasian continental

integration, many Eurasian countries experience strong economic growth and industrialisation, which in turn are associated with stronger ecological problems. Issues of environment protection in border regions or pollution call for cooperation across different countries of the continent. On the other hand, the increasing movement of goods, trade in services and somewhat larger migration are also used for illegal trade in drugs, human beings and firearms, which is strengthened by the presence of essentially lawless territories (like Afghanistan) in the direct vicinity of the borders of key Eurasian states and the inefficient corrupt bureaucracies in other countries. Finally, diseases also spread across Eurasia, much faster and with possibly more disastrous consequences than five hundred years ago. Hence, a certain form of top-down integration in Eurasia is also advisable.

## CONCLUSION

It remains to summarise the main arguments of this paper. First, we have presented three concepts of Eurasia, as they are used by researchers and practitioners. Clearly, the most troublesome is the second type of 'ideological' Eurasianism, which is hardly compatible with both empirical realities of market integration in Eurasia, as well as normative goals of modernisation and development. For us, it is crucial to stress that there exists a need to conceptualise and to understand Eurasia and Eurasian integration beyond the ideological Eurasianism, and there is no reason why the latter should keep monopoly rights on the application of the concept of Eurasia. As for the post-Soviet Eurasia versus Eurasian continent (and also post-Soviet Eurasian versus continental Eurasian integration) contradiction, here the situation is more complex. The authors of this paper themselves seem to mix up these concepts sometimes, as they do also in their publications in the EDB Eurasian Integration Yearbook. However, reserving the word 'Eurasia' merely for twelve post-Soviet states seems to rob this concept of the possible broad applications: it may be that referring to the region as 'Northern and Central Eurasia' (Vinokurov, Libman, 2012) is more applicable.

For us, however, two issues are crucial in this respect. First, continental Eurasian integration remains an under-studied phenomenon, which requires further work, especially empirical (for several areas, like informal trade, emergence of cross-border networks or FDI, we simply lack reliable data for more elaborated analysis). It is also an issue that should be taken into account by policy-makers and which is often overlooked. Second, for the post-Soviet space the interaction of two Eurasian integrations: the continental and the post-Soviet one, remains a crucial challenge. As of now, the post-Soviet regional integration projects face substantial difficulties in terms of coping with Eurasian economic ties; and although the understanding of the importance of this issue is growing, it is still insufficient. Thus, redesigning post-Soviet regional organisations in a way that is compatible with both European integration in the West and multitude of regional projects in Asia, as well as with the developing intraregional and

interregional economic interests of the post-Soviet companies and households, remains an issue of crucial importance.

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# 6

## Central Asian Regional Integration and Cooperation: Reality or Mirage?

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### INTRODUCTION

For centuries Central Asia<sup>1</sup> was in the backwater of global political and economic attention, tales of “Great Games” and “Silk Roads” notwithstanding. However, interest in Central Asia from outside the region has been on the rise in recent years: Central Asia’s energy resources are of great importance to its neighbours in Europe and Asia. In addition, China wants a peaceful backyard, while Russia considers Central Asia part of its historical economic and regional interests and draws heavily on Central Asia migrants. Turkey is attracted by the common Turkic heritage of the region. Iran shares language and cultural ties with the Tajik people. The Central Asia’s Islamic tradition connects it with the Middle East and other Islamic countries. And now NATO countries rely on Central Asia for transit of their nonlethal military supplies in their engagement in Afghanistan.

There is wide agreement that economic prosperity and political stability in Central Asia is critical not only for the 60-plus million inhabitants of the region, but also for Central Asia’s neighbours, since Central Asia serves as a strategically important land bridge between Europe and Asia. Since the five Central Asian countries are landlocked small economies, a critical prerequisite for long-term

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<sup>1</sup> Central Asia is here defined as comprising the five former Central Asian Soviet republics: Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.

economic growth and political stability is successful economic integration underpinned by effective regional cooperation<sup>2</sup>.

This paper therefore addresses the central question of what are the prospects for regional economic integration and regional cooperation in Central Asia. It starts by briefly reviewing the role of Central Asia in the context of the overall process of Eurasian continental economic integration. It then considers what are the benefits and obstacles of regional integration and cooperation in Central Asia against the backdrop of lessons of international experience with regional integration and cooperation, and looks at four of the most important recent regional cooperation initiatives. In closing, the paper provides an answer to the question whether regional integration and cooperation in Central Asia are for real or only a mirage.

### CENTRAL ASIA AT THE CORE OF EURASIAN ECONOMIC INTEGRATION

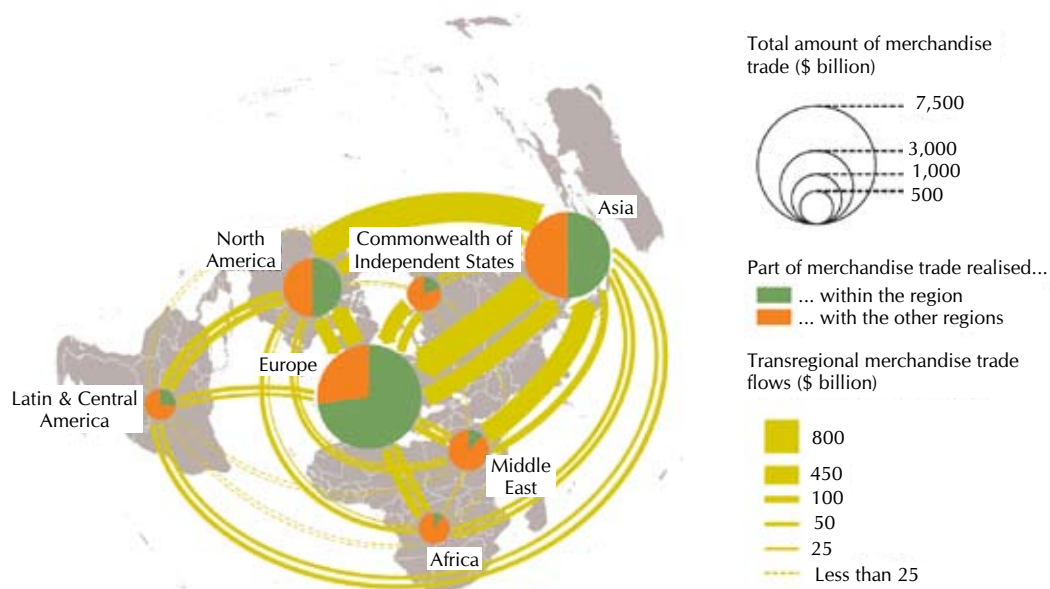
Central Asia lies in the heart of the Eurasian continental space, where Eurasia is defined to cover all of Europe and Asia, including the Middle East and Arab Peninsula. The opening up of China to the rest of the world in the early 1980s and the disintegration of the Soviet Union in the early 1990s, tore down the political barriers that had held back the continental economic integration process of Eurasia. This meant that Eurasia could now catch up with the economic globalisation process that had advanced rapidly in the rest of the world after the Second World War<sup>3</sup>. One indicator of the rapid integration process of Eurasia is that today the largest share of world trade takes place between Eurasian economies as shown in *Figure 6.1*. While much of the trade is carried on traditional maritime routes, the long-term potential for land routes to take on an increasing share of continental trade – from traditionally minimal levels – is significant, as other continental integration processes have shown, most notably in Europe and North America.

These developments are of great significance for Central Asia. During Soviet times, Central Asian economies were mostly oriented towards Moscow. Now they can increasingly look towards China, South Asia, Europe and the Middle East to gain access to markets, while maintaining strong links with Russia. Central Asia's neighbours make up a large share of the global economy and count among them the most dynamic economies of the world. Where previously it might have been accurate to consider Central Asian countries as handicapped by their

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<sup>2</sup> "Regional economic integration" refers to the economic links formed between economic agents in different countries of a particular geographic region through trade, transport and communications, financial flows, and migration. "Regional cooperation" refers to the coordination of efforts by governments to provide the necessary public infrastructure that supports regional economic integration and to remove barriers to regional integration that may arise from national policy regimes. (Linn, 2011)

<sup>3</sup> See Linn and Tiomkin (2006) for a full exploration of the evidence on Eurasian economic integration, and Linn (2007) and Linn (2011) for a discussion of the significance of Eurasian integration for Central Asia.



**Figure 6.1.**  
**Global trade flows**  
(2008, \$ billion)

Source: Gill and  
Raiser (2011)

land-locked position, it is now more appropriate to think of them as facing great opportunities for being “land-linked” to the world’s great and dynamic economies<sup>4</sup>. Not only will they benefit from access to their neighbours’ goods, energy, capital and labour markets, but also from the potential transit trade which will develop across Central Asian territory in linking Europe and Asia from East to West and North to South.

One way to look at this potential process is to compare Central Asia with the successful, small, land-locked countries of Europe: Austria, Liechtenstein, Luxembourg and Switzerland, and now Czech Republic, Hungary and Slovakia. Rather than suffering from their land-locked location, these countries have long taken great advantage of the historic economic integration process of Europe and been able to create great prosperity for their citizens<sup>5</sup>.

### CENTRAL ASIA’S REGIONAL ECONOMIC INTEGRATION AND COOPERATION: BENEFITS AND OBSTACLES

For Central Asian countries to benefit from access to their big neighbouring economies they have to overcome the legacy of disintegration that haunted all of

<sup>4</sup> The idea of Central Asia benefiting from a “land-linked” status can be found in CAREC (2012)

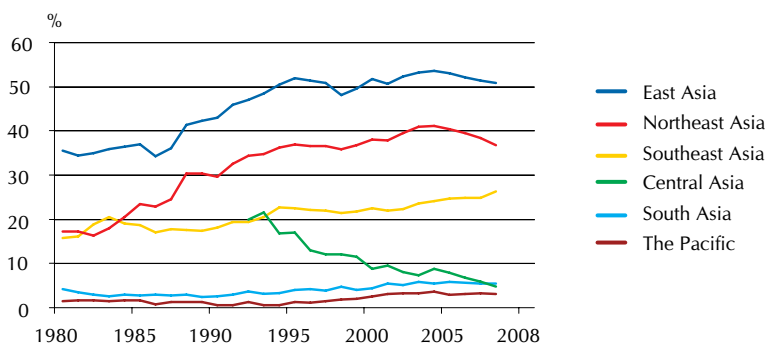
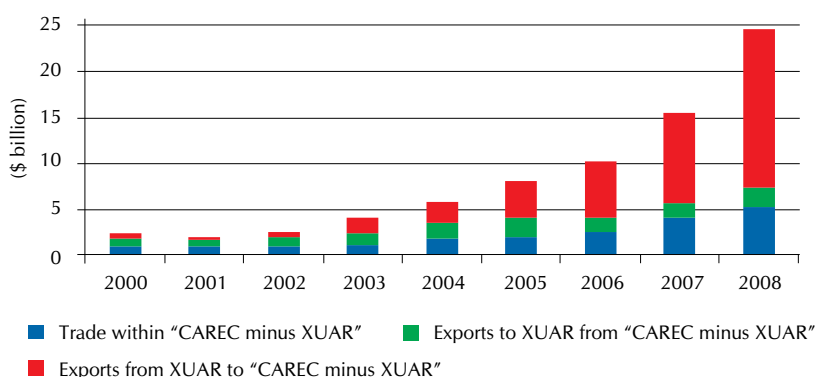
<sup>5</sup> Geographic distances to neighbouring economic centres are of course much greater for the Central Asian countries than for the land-locked countries of Western and Central Europe. But with the advances in transport and communications technology, economic distances have shrunk dramatically over the last 150 years, and especially over the last 50 years.

the former Soviet republics. As the Soviet Union broke up, the long-established intensive economic links between the republics were dramatically ruptured. This contributed to the deep and protracted economic downturn throughout the Former Soviet Union (FSU) (Linn, 2004). Central Asian countries, along with the rest of the FSU, recovered from the transitional economic recession beginning in the late 1990s, and indeed during the 2000s emerged as one of the most dynamic economic regions in the World (chalking up average growth rates of 8-10%) (IMF, 2011). They re-established growing trade links with each other, with their big neighbours and with the rest of the world. Figure 6.2 shows that

**Figure 6.2.**  
Trade Growth in  
Central Asia, 2000-  
2008 (\$ billion)

Source: CAREC, 2010  
(based on unpublished  
research by Roman  
Mogilevskii)

Note: "CAREC" covers  
the membership of the  
Central Asia Regional  
Economic Cooperation  
Programme before  
enlargement in  
2010 (Afghanistan,  
Azerbaijan, Kazakhstan,  
Kyrgyz Republic,  
Mongolia, PRC,  
Tajikistan, and  
Uzbekistan). "CAREC  
minus XUAR" excludes  
Xinjiang Uyghur  
Autonomous Region,  
China



**Figure 6.3.**  
Intraregional trade  
shares in Asia

Source: ADB, 2010

intraregional trade between Central Asian countries grew five-fold during 2000-2008<sup>6</sup>. However, despite this rapid growth, the share of intraregional trade in Central Asia relative to the region's overall trade dropped dramatically after independence while it increased in other part of Asia (see Figure 6.3).

<sup>6</sup> Figure 6.2 shows a broader country grouping for Central Asia than generally used in this paper by including countries that were members of the Central Asian Regional Economic Cooperation programme (CAREC) as of 2010.

This demonstrates that there remains much to be done to improve the interconnectedness of the five Central Asian countries with each other and with their neighbours. The Asian Development Bank (ADB) and UNDP carried out a comprehensive assessment of trade opportunities and constraints in 2005 and found that average trade cost and time requirement for shipments to and from Western Europe from and to Central Asia, and within Central Asia were about twice those expected with normal transport conditions (ADB, 2006; UNDP, 2005). The principal reasons for these elevated time and monetary costs were delays and costs (both legal and informal) of border crossings, behind-the-border barriers (poor logistics, police barriers, illicit fees, etc.) and infrastructure structure bottlenecks. The ADB and UNDP reports projected significant potential increases in trade and resulting benefits from systematic improvements in these areas. Moreover, with a halving of the cost of transcontinental shipments through Central Asia, the region would become cost competitive with maritime shipping, while further enhancing its advantage in terms of much shorter time requirements<sup>7</sup>.

In addition, the UNDP report identified a number of other areas in which regional cooperation would generate significant benefits, including improved use of the regional energy and water resources, improved preparedness for natural disasters, and prevention of conflict. Very roughly, UNDP (2005) estimated that the potential benefits of effective regional cooperation for the countries of Central Asia could lead to a possible doubling of regional GDP over 10 years, over and above the level achievable without cooperation<sup>8</sup>.

In short, there is little doubt among economists that the benefits from regional economic integration and cooperation are significant for Central Asia. However, there are many obstacles to realising these gains in the political and governance realms. In the political arena, all the leaders of the newly created states of Central Asia prize their countries' sovereignty, while some of them compete with each other for control of resources, especially water and energy (Tajikistan and Uzbekistan), and for supremacy in regional leadership (Kazakhstan and Uzbekistan), or prefer to operate in strict neutrality to the point of isolation (Turkmenistan) (Olcott, 2011). In terms of governance, Central Asian countries

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<sup>7</sup> See Pomfret (2011) for comparative cost and time data of maritime and overland routes in Eurasia. A further factor to consider is the newly elevated risk from piracy for shipping routes through the Indian Ocean.

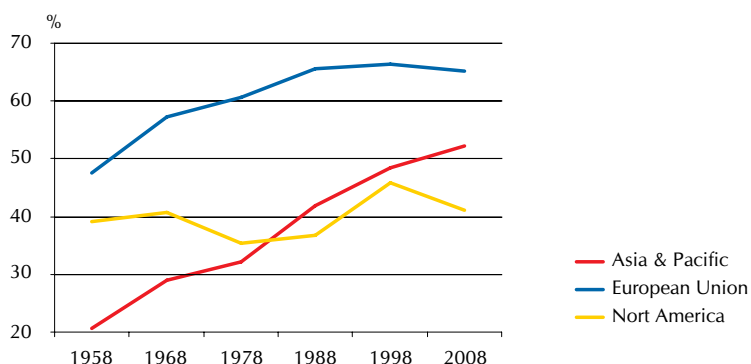
<sup>8</sup> This is on the high side among available estimates of the benefits of cooperation. A recent review of benefits from regional cooperation around the world showed estimates of benefits from tariff reductions in Asia to be relatively minor; benefits from infrastructure investments and quality improvements in the range of 10–20% of GDP over 10 years; and for the Maghreb region in North Africa the benefits from entering a trading bloc with the European Union, the liberalisation of services, and investment climate reforms have been estimated at 40–60% of GDP over 10 years (Linn, 2011). For a skeptical view of estimates of benefits from regional trade integration see Prokop (2012).

suffer from limited or poor accountability in public decision-making and policy, pervasive corruption, smuggling and drug trade, all of which serve the interests of the governing elites and undermine their willingness and ability to control security forces and border control agents effectively. Accordingly, governments find it difficult to implement their stated intentions to pursue the goals of improved border management, control of drug trafficking, and reduced behind-the-border harassment of private business and investors (de Tray, 2011; Shishkin, 2012).

This begs the question whether regional integration and cooperation in Central Asia have a chance to succeed. To answer this question it helps to consider the experience with regional integration and cooperation elsewhere in the world, a topic that we turn to next.

### THE INTERNATIONAL EXPERIENCE WITH REGIONAL INTEGRATION AND COOPERATION

Along with the global economic integration process worldwide, regional integration (as reflected in the rising share of intraregional trade in total trade) has progressed rapidly in many parts of the world. Leading the pack is Europe, but it is closely followed by Asia (see Figure 6.4). However, regional integration



**Figure 6.4.**  
Intraregional Trade Shares

Source: ADB, 2010

has not been matched by equal progress with regional cooperation in most regions. In fact, most efforts to create and sustain regional organisations have fallen woefully short of lofty political pronouncements. Even the European Union, long held out as the paragon of successful regional cooperation, has always had notable shortcomings in the way the regional institutions have functioned and Europe has recently run into dramatic problems as a result of the poorly designed common currency project of the Euro, combined with weak macroeconomic management and structural policies in individual EU countries (Soros, 2012).

A recent review of the experience with regional cooperation initiatives worldwide and in Asia concluded with nine lessons that are highly relevant for Central Asia<sup>9</sup>:

1. Building effective regional institutions is difficult, takes a long time, and requires incremental, gradual, and flexible implementation with visible payoffs.
2. It is preferable to keep the number of members in sub-regional and regional organisations manageable. Membership should be based on shared geography and common regional interests.
3. Adequate funding mechanisms for regional investments are essential.
4. Successful cooperation requires leadership at the country, institutional, and individual levels.
5. External assistance can be helpful in setting up and sustaining sub-regional institutions, but it cannot substitute for ownership of the process from within the region.
6. Open regionalism – i.e., the creation of institutions that are open to extra-regional participation and do not discriminate against non-regional economies in the long term – is the most successful strategy as demonstrated in the case of East and South-East Asia.
7. Regional economic cooperation organisations that involve ministries of finance or economy and central banks tend to be more effective than those that rely on the leadership of line ministries or foreign affairs.
8. Transparency and the engagement of the business community and civil society strengthen the mechanisms for regional cooperation.
9. Monitoring and evaluating the performance of countries under regional agreements is important, as are incentives for better compliance.

#### RECENT REGIONAL COOPERATION INITIATIVES IN CENTRAL ASIA

For Central Asia, as we have noted earlier, intraregional trade has expanded significantly in terms of volume, but its share in total trade dropped precipitously since the 1990s. In part this reflects three factors: (a) overall trade expanded very rapidly, more rapidly than GDP, as the ratio of trade to GDP rose from an already high level of 63% in 2000 to 76% in 2008 (ADB, 2010); (b) Central Asian economies have similar economic structures and all rely principally on natural resource based exports<sup>10</sup>, and hence one would expect relatively low

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<sup>9</sup> This section is based on Linn and Pidufala (2008) and Linn (2011)

<sup>10</sup> In Soviet days, Central Asian countries actually had a differentiated industrial base, but much of this was destroyed as a result of the collapse of the Soviet Union (Linn, 2004).



intraregional trade shares; (c) where there were no external borders and hence no trade barriers within the Soviet Union, countries in Central Asia introduced significant barriers to economic exchange across their sovereign borders after independence<sup>11</sup>.

Despite – or maybe because of – this trend, there was no dearth of efforts to create regional organisations to foster regional cooperation in support of regional economic integration involving Central Asian countries. On the contrary, a large number of regional organisations and forums were set up in the years following the collapse of the FSU, with overlapping memberships and mandates creating a “spaghetti bowl” of regional institutions. Most of the regional organisations in Central Asia have been characterised by weak organisation and funding, with little or inconsistent engagement by key countries and national leaders, and none of them was able to affect decisively the way in which the countries of the region cooperated in the economic sphere (Linn, Pidufala, 2008). In fact, many of the obstacles that have prevented effective regional cooperation through regional organisations in the rest of the world have also been at work in Central Asia: lack of ownership and political commitment by leaders (despite public statements to the contrary), lack of funding mechanisms, lack of transparency, lack of engagement by the private sector and civil society, and lack of a clear results agenda and monitoring of progress.

There are some signs, however, that regional cooperation has been given a new impetus in the last few years, albeit coming from very different directions. In the remainder of this paper we will focus on four of the most prominent examples: The Shanghai Cooperation Organisation (SCO), led by China and Russia; the Eurasian Economic Community, led by Russia; recent initiatives focused on integrating Afghanistan with its neighbours, led by the United States and Europe; and the Central Asia Regional Economic Cooperation programme (CAREC), led by the Asian Development Bank with the support of China.

### **The Shanghai Cooperation Organisation**

The SCO was formally established in 2001 with six members: China, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan and Uzbekistan<sup>12</sup>. They declared that the “Shanghai Spirit”, i.e., “mutual trust and benefit, equality and consultation, respect of diversified civilisations, and seeking common development”, represents the guiding principle of the organisation as members seek to cooperate in three areas: security, economics, and humanitarian concerns

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<sup>11</sup> These barriers were not principally due to high tariffs, but due to non-tariff barriers, including quantitative restrictions, arbitrary, costly and time-consuming border crossing conditions, and poor logistical support. See, for example, UNDP (2005).

<sup>12</sup> Subsequently, India, Iran, Mongolia, Pakistan and Afghanistan obtained observer status and Belarus, Sri Lanka and Turkey are “dialogue partners”.

(Yang, 2012). While principally focusing on Central Asian regional security concerns, including cross-border drug trafficking, terrorism and crime, the SCO since 2003 also has made regional economic development and cooperation one of its goals. However, to date SCO has not been able to deliver much that represents significant progress in terms of regional economic cooperation (Linn and Pidufala, 2008).

A number of factors explain this. First, the leading two member countries, China and Russia, do not necessarily see eye to eye on key regional economic development challenges, such as energy and trade development, with Russia concerned about China's growing influence in the Region and its interest in maintaining control over regional oil and gas transit (Cooley, 2012a). Second, since the SCO operates on the principles of consensus decision-making and non-interference, it is not in a good position to resolve conflicts among members, such as border closures or regional water management conflicts. Third, while China supports the Central Asian members of SCO with significant financial resources<sup>13</sup>, notionally under the umbrella of SCO and in support of regional infrastructure, they are in fact bilateral financial flows; the Interbank Consortium which was established by SCO in 2009 does not appear to have developed into an effective financial coordination mechanism for funding regionally coordinated infrastructure investments. Fourth, SCO has not established close relationships with any of the other regional organisations, even where there could be complementarities, as for example in the case of CAREC (see below). Finally, the Secretariat of SCO, based in Beijing, has a limited mandate and limited technical capacity for developing, implementing and monitoring effective economic cooperation strategies for Central Asia.

A number of these constraints were highlighted in connection with official contributions to the 2012 SCO summit in Beijing, including by the Chinese President Hu Jintao who "called for the SCO to be built into an effective platform for increasing international exchange and influence", and by Chinese Vice Foreign Minister Cheng Guoping, who referred to the need to "balance regional stability versus the principle of non-interference", to balance "the ability to act versus adhering to the principle of consultation to reach consensus", and the need "for the SCO to improve its process, rationalise the working mechanism, and improve its decision-making efficiency (China Weekly, 2012; Cheng, 2012)". And Sun Changhong, Deputy Director of the Eurasian Research Institute of the State Council Development Research Centre, commented that SCO is progressing with "setting up conferences and meetings, and reaching resolutions and agreements, but they lack specific targets and specific implementation"

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<sup>13</sup> At the 2012 SCO summit in Beijing, China announced a \$10 billion loan package for Central Asia. (Reuters, June 6, 2012, <http://www.reuters.com/article/2012/06/07/us-china-sco-loans-idUSBRE85602920120607>; last accessed July 20, 2012)

(Sun, 2012). Thus it appears that China in particular wishes to turn SCO into a more effective regional organisation for economic cooperation in Central Asia than it has been hitherto.

### The Eurasian Economic Community

After a decade of limited effectiveness since its foundation in 2000, EurAsEC<sup>14</sup> has recently become much more active. Russia and Kazakhstan, together with Belarus, have with surprising speed and apparent success set up a customs union, effective July 2011, when the customs barriers came down between these three countries. The customs union may expand to include Kyrgyzstan and Tajikistan, but will likely not extend to Turkmenistan and Uzbekistan in the foreseeable future. Fourth, and most recently, in October 2011, the then Prime Minister Putin announced plans for the establishment of a Eurasian Economic Union, which would push ahead with further market integration among its members (Halbach, 2012).

These recent efforts followed two earlier, related initiatives: First, in 2006, Russia and Kazakhstan set up the Eurasian Development Bank, which now also has Kyrgyzstan and Tajikistan (in addition to Armenia and Belarus) among its members. While EDB is not formally affiliated with EurAsEC, it finances the development of national and regional resources and infrastructure in EDB's member states, which are broadly similar to those of EurAsEC<sup>15</sup>. Second, Russia and Kazakhstan set up an "Anti-Crisis Fund" in 2008, managed by EDB, with \$8.5 billion in resources to support the poorer member countries in dealing with the fall-out of the 2008-2009 global financial crisis<sup>16</sup>.

Looking ahead, the strength of EurAsEC is that it has a strong national champion in Russia, a focused mandate on economic integration, and partners with an effective financing instrument (EDB). A limitation of EurAsEC is that it does not include key Central Asian countries (Turkmenistan and Uzbekistan) and does not fully conform to the principles of "open regionalism". As its reach extends and its internal cooperative mechanisms get stronger it may well reinforce barriers against non-members in Central Asia<sup>17</sup>. Finally, it is not clear whether Russia's ambition to create an economic union is serious and whether other current and prospective members of the customs union

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<sup>14</sup> Current members are Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan as members; Armenia, Moldova and Ukraine are observers (see EurAsEC, 2011).

<sup>15</sup> The members of EDB are Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan.

<sup>16</sup> Russia contributed \$7.5 billion, Kazakhstan \$1 billion, Belarus \$10 million, and Armenia, Kyrgyz Republic and Tajikistan \$1 million each (EurAsEC, 2011).

<sup>17</sup> Reportedly, the border controls between Kazakhstan and Kyrgyz Republic have been considerably tougher since the creation of the Customs Union (Smith, 2010). This has been one of the factors driving Kyrgyz Republic to seriously explore membership in the Union, even though it will also have significantly disruptive impacts on its trade with China, which had grown rapidly as Kyrgyzstan with its hitherto open borders had developed as an active transit trade route for imports from China into Central Asia.

share it, considering their likely resistance to a tight embrace by a dominant Russia.

### **Regional Initiatives focused on Afghanistan**

A second new regional initiative – or, more accurately, set of initiatives – is focused on the challenge of how to integrate Afghanistan into a regional integration process that will help it to strengthen its economic development and support its political stability, especially after 2014, when the current engagement of NATO forces in the country is expected to end. Based on a vision that sees Afghanistan as a “hub” or “roundabout” for Eurasian integration, and in particular for strengthening the North-South axis connecting South Asia with the rest of Eurasia (Starr and Kuchins, 2010), recent initiatives include the “New Silk Road Strategy” (NSRS) of the United States, the “Regional Economic Cooperation Conference on Afghanistan” (RECCA) and the “Northern Distribution Network” (NDN), which transfers nonlethal NATO supplies to Afghanistan.

The NSRS represents a vision and call to action rather than a well-articulated and organised strategy, let alone a regional organisation<sup>18</sup>. It endorses the concept of integrating the economy of Afghanistan with its neighbours as a hub for Eurasian economic integration. It calls on Afghanistan’s international partners to support the development of regional transport and energy corridors. With no substantial new resources contributed by the US or the Europeans beyond their continuing large financial engagement in Afghanistan and their low levels of aid to Central Asian countries, it is not clear that this initiative on its own will add much substantially to help regional integration in Central Asia.

Potentially of greater significance is RECCA, which represents a recurrent series of conferences involving Afghanistan, its neighbours, and international partners. The Fifth RECCA conference (RECCA V) convened in Dushanbe, Tajikistan, on March 26–27, 2012. It extended and deepened agreements among the participants in five areas: infrastructure (transport and energy), human resource development (including vocational training and labour market facilitation), investment and trade (including transit and border management), regional disaster risk management, and regional fiber optic connectivity. With commitments to support specific projects and institutional initiatives, and a well-articulated monitoring process of progress from one conference to the next, the RECCA process potentially can serve as a driver of regional cooperation initiatives. Among the major projects supported are improved rail and road links of Afghanistan with its neighbours, major regional energy transmission projects for and through Afghanistan<sup>19</sup>, and the development of

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<sup>18</sup> See Hormats (2011) for an official statement on the New Silk Road Strategy.

<sup>19</sup> Including the Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline and the Kyrgyz Republic-Tajikistan-Afghanistan-Pakistan electricity transmission line (CASA 1000).

regional institutions devoted to vocational training (in Tajikistan) and disaster management (in Kazakhstan) (RECCA, 2012).

Another development involving Afghanistan, and of regional significance for Central Asia, is the Northern Distribution Network (NDN). Set up in 2009 to facilitate transport of non-lethal supplies for NATO from the Baltics through Russia and Central Asia as an alternative to the increasingly unreliable supply lines through Pakistan, the use of this transit route intensified with the "surge" of NATO presence in Afghanistan in 2010 and was especially important as Pakistan closed its border to NATO transit in 2011 and into 2012. While facing many obstacles and continuing challenges in managing the extended and costly transport lines<sup>20</sup>, NDN has demonstrated that the transcontinental transport routes involving rail and roads from Europe to Central and South Asia are viable alternatives to the traditional sea routes (Kuchins and Sanderson, 2010)<sup>21</sup>. As the NATO military engagement in Central Asia winds down in the run-up to 2014, it is expected that NDN will also serve to support the removal of equipment from Afghanistan (Tynan, 2011).

In sum, the focus on Afghanistan as a key connecting hub in Eurasia and the need to stabilise its economic and political development has served to place a lot more attention on the broader neighbourhood in which it lies, and especially on Central Asia. Moreover, for Central Asia a stable, prosperous Afghanistan is critical, not only to avoid the disruptions that could once again emanate from a conflict-ridden neighbour (refugees, terrorism, drugs, etc.), but also to gain access to Central Asia, to the dynamic economies of South Asia and as the shortest and cheapest way to connect to sea ports and hence to world markets. Unfortunately, the prospects for turning around Afghanistan on a lasting basis are at this time at best uncertain, and so it is not clear if Afghanistan in future is a plus or minus for the longer term development and integration of Central Asia into the world economy.

### **Central Asia Regional Economic Cooperation program<sup>22</sup>**

In 2011 CAREC celebrated its 10<sup>th</sup> anniversary of existence as a regional forum for Central Asia. It emerged from a regional initiative for Central Asia started by the Asian Development Bank in the late 1990s. The first of the annual ministerial conferences of CAREC convened in 2002<sup>23</sup>. It set in motion a

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<sup>20</sup> Critics have charged that NDN has supported authoritarian regimes, reinforced local corruption at borders, and failed to encourage local private enterprise (Cooley, 2012b).

<sup>21</sup> However, according to Pentagon data, the cost of shipping a container on NDN remains substantially higher than the alternative route through Pakistan (\$17,500 compared to \$7,200 per container) (Tynan, 2012).

<sup>22</sup> The author served as Special Adviser to CAREC from 2006–2010. This section is informed by his observations gathered in that capacity. For official documentation on CAREC see <http://www.carecprogram.org/> (last accessed on July 20, 2012).

<sup>23</sup> The 2002 Ministerial Conference brought together five member countries (China, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan). Azerbaijan and Mongolia joined in 2003, Afghanistan in 2005, and Pakistan and Turkmenistan in 2010. In addition, six multilateral institutions are members of CAREC: ADB, EBRD, IsDB, UNDP, and WB.

substantial effort to support the intraregional economic integration of Central Asia and its integration with its neighbours, modelled on the example of the Greater Mekong Subregion Programme (GMS), also initiated and supported by ADB beginning a few years earlier<sup>24</sup>.

Like GMS, CAREC is focused on a limited number of areas of regional cooperation, involving principally the development of regional trade, transport, and energy corridors. Like GMS, CAREC is not a formal treaty-based organisation, but an informal forum, supported by an organisational structure that comprises annual ministerial meetings, complemented by more frequent meetings of senior officials and of technical committees which prepare sectoral strategic plans and investment programs. Like GMS, CAREC enjoys the strong support of China, which participates actively in both.

CAREC's current membership consists of 10 countries and six multilateral institutions<sup>25</sup>. The participation of multiple multilateral agencies is a unique aspect of CAREC (not found in GMS or any other regional organisation). It allows the cooperation and coordination not only among the member countries but also among the key financial supporters of regional integration. ADB staffs and manages the CAREC Secretariat. Unlike GMS, CAREC has not yet seen the direct engagement of the member countries heads of state or heads of government.

CAREC's principal goal is development through cooperation, based on the vision embodied in its motto: "Good neighbours, good partners, good prospects". In the course of its existence, it has formulated a clear and persuasive vision of why regional integration and cooperation matters for Central Asia and for its neighbours, based on the notion that its location at the core of the dynamic Eurasian continental economic space allows it to transform its traditional handicap of land-locked location into an advantage of land-linked development (CAREC, 2012)<sup>26</sup>.

In its first 10 years of existence CAREC saw strong growth in regional investments and technical assistance activities, funded primarily by the multilateral agencies, with ADB as a principal source. Most investments were in the transport sector (see Table 6.1 and Figures 6.5 and 6.6).

Much of the investments took place after 2006, when CAREC ministers approved its Comprehensive Action Plan and developed sectoral strategies that provided roadmaps for agreed follow up. By 2011, CAREC member countries

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<sup>24</sup> For a brief summary of GMS see Linn and Pidufala (2008)

<sup>25</sup> See footnote 26.

<sup>26</sup> This theme was first introduced to CAREC ministers by the author in a presentation at the 2007 Ministerial Conference in Dushanbe, Tajikistan (Linn, 2007).

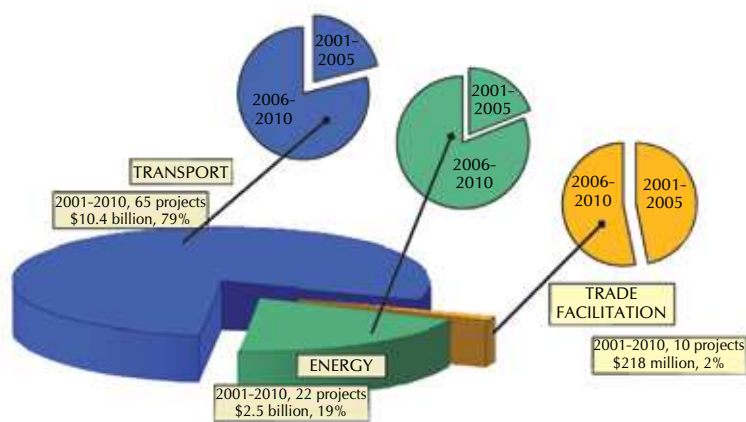
Indicator	2001	2006	2010
Number of investment projects approved (loans and grants; cumulative since 2001)	6	43	96
Annual average volume of new approved investment projects (loans and grants; 3-year rolling average, \$ million)	444.5	630.8	2,862.2
Volume of approved investment projects (loans and grants; cumulative since 2001, \$ million)*	247.1	3,227.9	13,191
Number of technical assistance projects approved (cumulative since 2001)	3	77	153
Annual average volume of new approved technical assistance projects (3-year rolling average, \$ thousand)	6,814	13,413.3	13,747.3
Volume of technical assistance projects (cumulative since 2001, \$ thousand)	2,476	60,682	136,334
Number of completed technical assistance projects (cumulative since 2001)	3	64	73

**Table 6.1.**  
**CAREC Operations**  
**in 2001-2010**

Source: Central Asia Regional Economic Cooperation Programme Project Portfolio

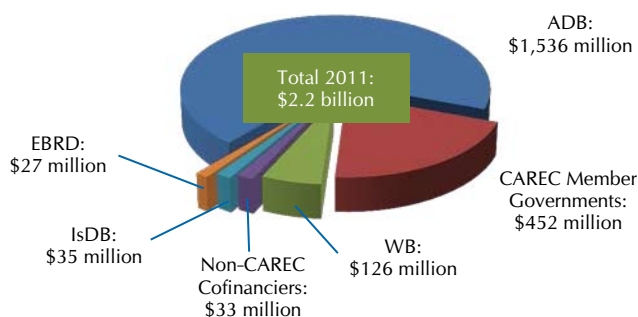
Note: Where rolling averages are used, 2001 reflects data for 2001-2003, 2006 reflects data for 2004-2006, and 2010 reflects data for 2008-2010.

\* Figures include only disbursed tranches of multifinancing facility investments.



**Figure 6.5.**  
**CAREC Investment**  
**Loans and Grants,**  
**by Sector and Date**  
**(2001-2010)**

Source: CAREC Project Portfolio, 2010



**Figure 6.6.**  
**Financing of CAREC**  
**Programs (2011)**

Source: CAREC, 2011a



and organisations had approved a total of \$14 billion in funding for regional investments and advisory activities under the CAREC umbrella.

CAREC's strongest area of engagement has been in the area of transport and transit and trade facilitation. The CAREC Transport and Trade Facilitation Strategy (TTFS) identified six priority transport corridors traversing Central Asia east to west and north to south and connecting with Eurasian transport arteries. For each corridor, TTFS noted infrastructure bottlenecks as well as key border crossing points and their investment requirements, as well as complementary needs to improve border transit and logistics arrangements. A core component of TTFS was the establishment of a corridor monitoring programme under which the time and cost of transit was to be measured based on regular vehicle surveys, allowing CAREC to assess whether and where the investments and procedural improvements along the corridors actually led to progress in reducing transport and transit barriers and where further action was needed.

CAREC has a number of strengths, in line with many of the lessons from the international experience of regional cooperation identified above:

1. CAREC is an action-oriented, pragmatic alliance of countries and institutions, with a long-term vision and a clear focus on a few key priority sectors.
2. It builds mutual understanding and consensus through work in its technical committees and senior officials meetings, leading to constructive discussions and agreements in the ministerial conferences.
3. Countries participate in CAREC through their technical ministries (Finance, Economy, Transport, etc.).
4. CAREC developed a good action plan and sectoral strategies with a clear results framework, against which progress is monitored and evaluated regularly<sup>27</sup>.
5. It mobilised the multilateral organisations' financial resources for coordinated investment and capacity building.
6. It has supported the creation and dissemination of knowledge products and the development of training initiatives, through its affiliate, the CAREC Institute<sup>28</sup>.

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<sup>27</sup> In 2010 the CAREC secretariat carried out an assessment of progress achieved during CAREC's first 10 years of existence (CAREC, 2010). Since 2009, it also prepares annual development effectiveness reviews which report progress against baseline indicators in key results areas. So far, no independent evaluation of CAREC's performance has been carried out.

<sup>28</sup> The CAREC Institute was set up in 2006 as a "virtual" entity, managed by ADB.



7. CAREC has developed a transparent approach to reporting on its work, with its public website ([www.carecprogram.org](http://www.carecprogram.org)) making available key documentation of CAREC sponsored meetings and events.

CAREC also faces many challenges, not unlike those confronting other regional institutions<sup>29</sup>:

1. Some key regional players are missing, foremost among them Russia<sup>30</sup>. Russia was formally invited to join CAREC in 2006 and sent a delegation as an observer to the ministerial conference in 2006, but never formally responded to the invitation. Since then it appears that CAREC members have lost interest in getting Russia to join, even as the membership was expanded to include Turkmenistan and Pakistan in 2010<sup>31</sup>.
2. While CAREC actively and overall successfully pursued the transport and trade facilitation agenda since its inception, it made significantly less progress in the energy and trade policy areas. Moreover, the critical area of water resource allocation and management was excluded from the CAREC agenda at the outset, at the behest of China and Uzbekistan, ostensibly because they feared that the topic was too sensitive and best dealt with on a bilateral basis.
3. Progress has been greater in regard to physical infrastructure investments, less so in the "soft" areas of improving the legal, regulatory, and administrative aspects of trade, transport, and energy sector management.
4. CAREC has not attracted the attention of the top leadership in Central Asia. Because of that, and because of limited efforts at building broader stakeholder awareness in the region, CAREC has not been able to gain a lot of visibility in Central Asia as an important regional forum.
5. Links between the regional sector strategies formulated in CAREC and national sector strategies have been weak or absent, and forward planning for specific investment projects under CAREC's tutelage has been limited. These factors have constrained CAREC's ability to follow through effectively on its sector strategies.
6. The intensity of cooperation among the multilateral agency members of CAREC has suffered in recent years, as the regular consultation meetings among them withered and inconsistent engagement by the individual agencies at senior levels left ADB with a near-exclusive responsibility for managing the CAREC processes.

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<sup>29</sup> Many of the issues highlighted here were identified in CAREC's 10-year retrospective (CAREC, 2010).

<sup>30</sup> Other potentially important neighbours, who are currently not members of CAREC, are India, Iran and Turkey.

<sup>31</sup> One complication is that Russia is not a member of ADB. Since ADB plays a central role in supporting the work of CAREC, this has been seen as an obstacle for Russia and current CAREC members.

7. Links with non-member partners and other regional organisations have been at best sporadic. CAREC organised two development partner meetings (in 2009 and 2011) for information purposes and has invited official partners to participate in some of its technical committee meetings. The CAREC Secretariat also engaged in some outreach to and meetings with other regional organisations in Central Asia. However, these efforts have at best helped a limited exchange of information, and have not yet resulted in effective coordination among partners and organisations<sup>32</sup>.
8. Participation of and interest from the private sector and civil society has been limited to date. CAREC organised two business forums and some outreach events to civil society organisations (CSOs) in member countries. However, this has not led yet to serious private sector and CSO engagement.
9. The work of the CAREC Institute has been, at best, of limited impact. Its training activities did not focus on specific sectoral and regional capacity building needs, its analytical work has to date not produced significant results, and its networking with knowledge institutions (universities, think tanks, etc.) in the region has been limited.
10. The work of the CAREC secretariat, while of high technical quality, suffered from the fact that after 2007 ADB moved the secretariat, which previously had been located in Almaty, Kazakhstan, to ADB headquarters in Manila, Philippines. This substantially reduced the secretariat's effectiveness in building greater understanding, consensus and capacity for regional cooperation needs among the stakeholders in Central Asia.
11. CAREC has been unwilling or unable to address, let alone resolve, a number of key issues and events that represent a direct challenge to progress in its core mandate of fostering integration through improved trade, transport, trade facilitation and energy cooperation. Among these are the following:
  - The tensions between Tajikistan and Uzbekistan over Tajikistan's intentions to build the hydro-dam at Rogun; this has led to actions by Uzbekistan that have severely affected Tajikistan, including selective border closures, interference with rail transit and blockage of Tajikistan's access to electricity and gas imports<sup>33</sup>.
  - During the food crisis of 2008-2009 Kazakhstan blocked exports of grain, including to its Central Asian neighbours, in the interest

<sup>32</sup> For a summary of the CAREC Development Partners' Forum in Baku in November 2011 see CAREC (2011b). Participation at that Forum was limited, with statements by non-member representatives made only for the bilateral aid agencies of France, Germany, Japan, the UK, and the US. It should be noted that closer partnership with other organisations also requires receptivity on the prospective partner's side, which has not always been forthcoming.

<sup>33</sup> Uzbekistan has a long-standing practice of severely restricting border exchanges, including mining of some of its borders (UNDP, 2005).

of protecting its domestic consumers. During the unrest in Kyrgyz Republic in 2010 Kazakhstan unilaterally closed the Kyrgyz-Kazakh border.

- The Belarus-Kazakhstan-Russia customs union led to new barriers at the Kazakh-Kyrgyz border, which however the countries' authorities are currently aiming to resolve.
- Kazakhstan and Uzbekistan abandoned the existing regional electric power dispatch mechanism that had existed in Central Asia since Soviet days, directly undermining the development of a regional energy market, one of the key objectives of CAREC's energy sector strategic action plan.
- NATO planned and implemented its Northern Distribution Network without engagement of CAREC<sup>34</sup>.

In view of these many issues and constraints which CAREC has not been able to deal with, the ownership by its member countries of CAREC as a legitimate, relevant and effective instrument for fostering regional cooperation remains in doubt.

The CAREC Strategic Framework 2011-2020, which was approved by ministers in November 2011, promises to address some of the issues identified above, including efforts to increase country ownership and outreach, better linkage between regional and national plans, improved planning and sequencing of the multi-year project pipeline, a stronger CAREC Institute, and renewed efforts to engage the multilateral institutions, other donor partners, as well as private sector and CSO stakeholders. Key issues where the Strategic Framework is silent include (a) how to engage the country leadership more directly<sup>35</sup>, (b) how CAREC can deal with hot-spots of regional tensions and relapses in key areas of sectoral policies, and (c) when and how CAREC's Secretariat can become a truly regional entity that is located in Central Asia, and managed and staffed by Central Asians. As long as these three key issues are not effectively addressed and regional commitment to cooperation is in place, the effectiveness of CAREC will remain impaired and its sustainability uncertain.

The reality is that multilateral institutions do not have the mandate or the clout to generate political consensus on fractious or disinterested regional partners. But this is not to argue that it was a mistake for the multilateral institutions, and

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<sup>34</sup> It is notable, however, that the documentation for the US New Silk Road Strategy and the Regional Economic Cooperation Conference for Afghanistan refer explicitly to CAREC as a significant partner in implementing programs envisaged under these initiatives.

<sup>35</sup> The Strategic Framework notes in passing the possibility of a summit of heads of state or government. However, for this to materialise and result in an effective meeting, it will be critical to engage leaders early by creating their awareness of CAREC and of CAREC's potential contribution. In the case of GMS, heads of state were involved from early on, initially through direct consultations with ADB and the GMS secretariat and subsequently in recurring summits.

especially the ADB, to take on a lead role in creating and supporting CAREC. On the contrary, the fact that CAREC has been able to support key investments in regional infrastructure and some improvements in regional policies and administrative practices can be attributed to a significant degree to the excellent technical and financial contributions made by ADB and its multilateral partners. But, for the longer term, more country leadership and ownership in CAREC (and in other regional organisations) will be a necessary, if not sufficient, condition for success.

## CONCLUSION

Based on the preceding analysis we can now address the question: Is regional economic integration and cooperation in Central Asia a reality or a mirage?

After the disintegration of the Soviet Union and the resultant dramatic economic depression on Central Asia in the 1990s, the region experienced in the 2000s a process of rapid economic growth and of internal and external integration. Within Central Asia, connectivity between Kazakhstan, Kyrgyz Republic, and Tajikistan has increased<sup>36</sup>. There are growing links with Afghanistan. And there has been rapid growth in economic ties with some of the big neighbours, especially China and Russia. A key driver of this process of integration of Central Asia has been the larger process of continental integration of the Eurasian economic space. In this sense, economic integration of Central Asia has been a reality.

But there are serious gaps and major risks to this integration process. First, some of the countries in the region remain substantially closed to intraregional trade and also represent a hurdle to transit trade, especially Turkmenistan and Uzbekistan. As noted, border closures, lack of cooperation in the energy and water areas, and weak governance interfere with intraregional and extra-regional integration. The regional organisations in Central Asia have been fragmented and weak, unable to tackle the sources of interstate tensions, and with at best limited resources and mandates to address key regional infrastructure needs. In this sense, effective regional cooperation among Central Asian states, as beneficial as it would be, remains a distant dream.

This pattern of regional development – progressive economic integration, but hindered by weak institutional cooperation – is a phenomenon that can be found in all regions of the developing world. But four recent developments point to a possible intensification of the regional cooperation process in Central Asia: China's apparent intentions to turn the SCO into a more effective instrument to support regional economic cooperation; the Russian-led EurAsEC process and its progress in creating a customs union; the European-US led effort to support Afghanistan's regional integration process; and the ongoing efforts,

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<sup>36</sup> Even here, however, serious obstacles remain, including limited progress on the critical CAREC Corridor 5 (CAREC, 2012b).

supported by China, to strengthen the CAREC programme. Some links have been established between the third and fourth initiatives (CAREC is seen as an important instrument to support the Afghanistan integration process), but so far there have been few, if any efforts made to connect the SCO, EurAsEC, and CAREC processes.

Looking ahead, therefore, a key question will be whether SCO, EurAsEC and CAREC can develop effective coordination and even cooperation in key areas, taking advantage of complementarities and avoiding measures that could hurt non-member states or that would duplicate effort. As an influential player in all three organisations, Kazakhstan could play a major role in ensuring effective linkages between SCO, EurAsEC and CAREC. Russia and China, the most important players in SCO and respectively in EurAsEC and CAREC, should join with Kazakhstan and the other Central Asian countries to explore the potential for strengthening the synergies and minimising possible conflicts between these three regional bodies.

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# 7

## The Impact of Global Financial and Economic Instability on the CIS<sup>1</sup>

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The period from 2007 to 2012 was a period of increased turbulence in the global economy. After the US mortgage crisis (accompanied by the bankruptcy of major financial companies such as Bear Stearns and Lehman Brothers) caused

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<sup>1</sup> EDB (2012a) *The CIS Macromonitor*. March. Eurasian Development Bank. EDB (2012b) *Risks for Public Finance of the CIS Member Countries in Light of the Current Global Instability*. Eurasian Development Bank.



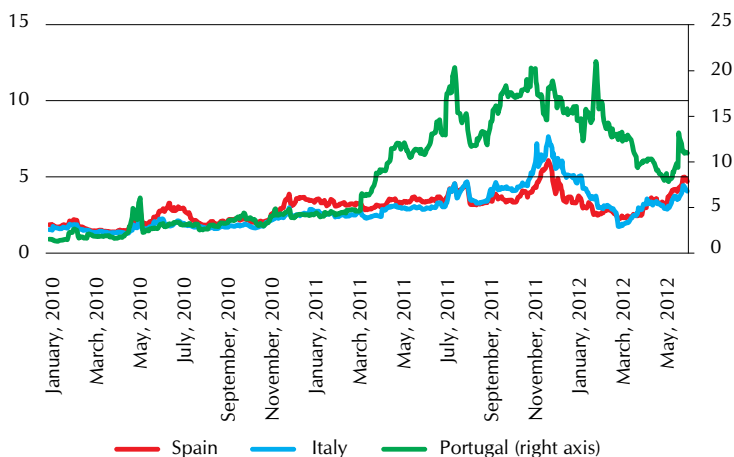
a drastic fall in economic activity and a slump in equity and commodity prices in 2008, economies and markets recovered considerably in 2009–2010 with the help of energetic fiscal and monetary incentives implemented by governments throughout the globe. The situation worsened in the second half of 2010 and, particularly, in late 2011 and early 2012, when the high government debt of some eurozone countries made investors doubt whether they could service it further. Over the past two years the European authorities have been looking for measures to mitigate the debt crisis by providing support to debtors through the European Central Bank (ECB) and newly created stabilisation mechanisms such as the European Financial Stability Facility (EFSF) and the European Stability Mechanism (ESM).

In the meantime, the debt crisis began to affect the economic situation in developed countries throughout 2011. In the fourth quarter of 2011, the eurozone economy had negative growth and international organisations predicted that it would remain in recession throughout 2012. The economic downturn in Europe has affected international trade: after an average increase of 15% in 2010, the growth of the global trade dropped by 6% in 2011 and 2.7% in the first quarter of 2012 and the growth in exports by developed countries declined to 2.4% and of developing economies to 3%.

Today, several factors exist that could potentially worsen the world's economic situation in 2012 and for the next several years.

#### a. Recurrences of the eurozone debt crisis

Since the stability of European economies with a high level of debt does not seem certain, many observers still believe their default and withdrawal from the eurozone to be the most probable outcome of the crisis. Despite the noticeable



**Figure 7.1.**  
Government  
bonds yield,  
2 years to maturity

Source: Bloomberg

positive effect the measures undertaken by the European authorities had on debt quotes of the largest economies affected by the crisis (Italy and Spain), government bonds quotes in more problematic countries remain low and debt servicing remains expensive for them. Therefore, it is possible that the debt crisis will periodically recur in Europe, requiring debt restructuring in a wide range of eurozone countries. The unfavourable consequences of this process for the financial sector and budgetary savings measures will have a negative effect on the global economic situation. Its extent will depend on what countries will be affected by recurrences of the debt crisis. If it does not go beyond small countries of the European periphery the related negative shocks can be rather moderate. If the debt situation in larger countries gets out of control, the consequences will be very significant. The breakdown of the eurozone (which is, however, seemingly unlikely) will have consequences that will be more serious than those of the 2008 US mortgage crisis.

#### **b. Fiscal consolidation in the US**

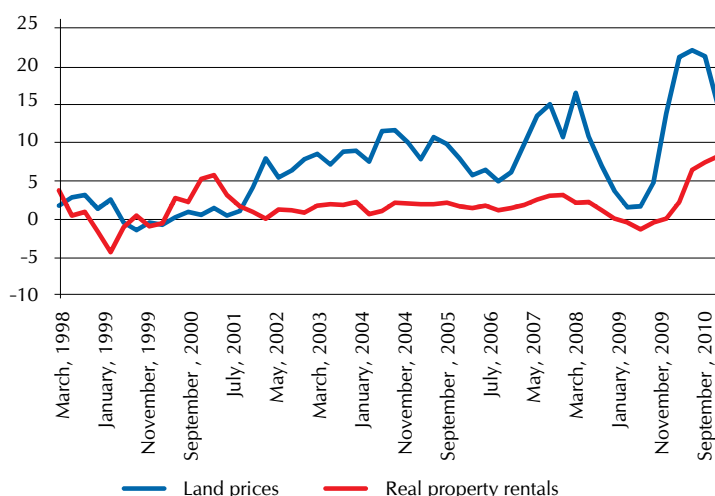
A reduction in the US government's expenditures because of the need to regain control over the growing public debt is another source of risks for the CIS countries. Despite the positive effect of this measure in the long term, its immediate effect will be a slowdown or a fall in economic activity in the US and, possibly, a decrease in the world prices of raw materials that form the exports of CIS countries. The lack of extensive direct trade ties with the US is not too important in this case: the trade in oil, metals and grain is of global nature and a decrease in demand for them in any part of the world will affect the prices of raw materials exported by the CIS.

It should be noted that the effect the situation in the US will have on the rest of the world will be considerably lighter than it was in 2008. First, even a rather decisive reduction in government expenditures will have a very limited effect on the country's economy. There are no grounds to expect that this will lead to a financial catastrophe as it was in the Lehman Brothers' case. Second, the political struggle in the US in the run-up to the presidential and parliamentary elections prevents radical measures from being taken in the sphere of budgetary policy, despite the intensity of the respective debates. In fact, we will only be able to talk about the tightening of the fiscal policy in the US from around 2013. Third, the overall situation in the American economy is changing for good. If this trend continues, fiscal consolidation, which is needed to recover the stability of public finance, can turn to be less radical than it seems necessary today.

However, earlier consolidation can be provoked by a large-scale crisis in another part of the world, most probably Europe, if, affected by it, investors become less confident of the reliability of the American government's debt obligations.

### c. Slowdown in economic growth and decrease in real property prices in China

The Chinese economy, whose renewed growth with the help of government incentives in 2009-2010 had significantly facilitated the recovery from the crisis for both China and the rest of the world, has again slowed down. This is partially due to a change in state policy in 2011: having faced overheating in the economy, which manifested itself in accelerating inflation and, in particular, a quick rise in real property prices, the authorities took measures to restrain the credit expansion, which have already brought results. As a result of this, inflation went down and the real property boom is fading out. In addition, the slowdown in China's economic growth has been caused by a number



**Figure 7.2.**  
Land prices and  
real property  
rentals in China  
(12-month  
dynamics)

Source: CEIC  
database

of longer-term factors: the demand for Chinese exports is falling because of difficulties in Western economies, while increasing prices and wages in the country make them less competitive. At present, China's monetary policy is being weakened to a certain extent since the previous year's tightening made it achieve its objectives at large. If the Chinese economy avoids disruptive developments, in particular in the financial sector (which was accumulating considerable volumes of bad debts during the previous credit expansion), China could even become a source of positive effects for the global economy. The fact that the authorities still possess very significant financial reserves makes this rather probable; however one should not rule out the possibility that the situation will change unfavourably. The financial crisis in China, as well as the hasty financial consolidation in the US, which we discussed above, can be caused by unfavourable events outside the country, for example in Europe.

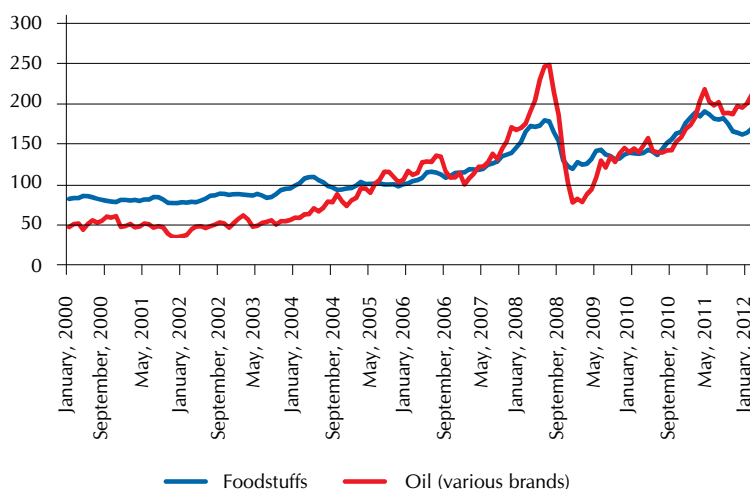
If this happens, the crisis will have a considerable impact on the global economy.

#### d. Growing energy and food prices

We have described the factors that can lead to a decline in prices of the CIS exports or hinder access for banks and companies from these countries to global finance. There is another threat however: because of the recovery of the world's leading economies, the soft monetary policies pursued by central banks, and the limited opportunities to boost production of the majority of energy and food commodities, energy and food prices could begin to grow in an unexpectedly quick fashion. In such an event, the situation will develop similarly to 2010, when energy and food prices also grew.

**Figure 7.3.**  
Food and oil price  
indexes (2005 = 100)

Source: International  
Financial Statistics



The CIS countries can very conventionally be divided into three groups that differ in terms of the condition of, and sources of finance for, their balances of payments and, accordingly, sources of tax revenues. These differences determine the channels for external negative effects on the economies in a certain group and, accordingly, the reaction of these economies to the development of the global situation and measures necessary to mitigate these effects. The following groups can be formed using these factors:

*Group 1.* Energy exporters (Russia, Kazakhstan, Azerbaijan, and Turkmenistan) have a significant export to GDP ratio, a positive balance of trade and a current account surplus. The share of raw materials exports in budget revenues is high. These countries have financial reserves which were accumulated during the favourable part of the 2000s, which however reduced considerably during

the 2008-2009 crisis. At present, these countries have a budget surplus, which is, however, considerably lower than in the pre-crisis period before 2008.

*Group 2.* The economies of Armenia, Moldova, Kyrgyzstan and Tajikistan are financed, to a considerable extent, by remittances from labour migrants and with the support of diasporas. Although the majority of these countries have certain (mineral and/or agricultural) resources, they are not large enough to make exports determine economic dynamics. These countries have considerable negative balances of foreign trade and current accounts. The tax base in these countries is primarily domestic economic activities. Because of the relatively difficult collection of taxes from this base (compared to taxes on raw materials exports), the budgets of the countries in the second group have chronic deficits and depend more or less on external finance.

*Group 3.* Belarus, Uzbekistan and Ukraine can be included in the third group. These countries have a diversified structure of exports and a considerable share of products with a relatively high level of processing, while they still have considerable raw materials exports. Their foreign balances are historically better than those in the second group. The budgetary policy in these countries is also

**Table 7.1.**  
Grouping indicators  
for the CIS countries  
(data for 2010)

Source: Trademap,  
national authorities

		Share of mineral products in exports (%)	Commodities accounting for more than 10% in exports	Current transfers (% of GDP)	Money remittances from Russia (% of GDP)
Exporters of oil and gas	Azerbaijan	95%	mineral products (95%)	1%	1.5%
	Kazakhstan	76%	mineral products (76%), metals (13%)	-0.3%	-0.3%
	Russia	66%	mineral products (66%), metals (10%)	-0.2%	-0.5%
	Turkmenistan	71%	mineral products (71%), textiles (20%)		0%
Exporters of labour	Armenia	31%	foodstuffs (17%), mineral products (31%), stone, cement, precious metals (16%), metals (28%)	6%	10.1%
	Kyrgyzstan	8%	foodstuffs (13%), textiles (11%), stone, cement, precious metals (46%), other items (11%)	29.1%	21%
	Moldova	1%	foodstuffs (48%), textiles (19%), machinery, equipment (11%)	22.8%	13.4%
	Tajikistan	4%	foodstuffs (18%), textiles (16%), metals (57%)	26.8%	38%
Exporters with a diversified structure of trade	Belarus	29%	foodstuffs (13%), mineral products (29%), chemical products (16%)	0.6%	0.3%
	Uzbekistan	24%	foodstuffs (10%), mineral products (24%), chemical products (14%), textiles (23%), metals (13%)		6.7%
	Ukraine	13%	foodstuffs (19%), mineral products (13%), metals (34%), machinery, equipment (11%)	-6.1%	1.4%

historically stronger than in the majority of countries in the second group, but the stability of their public finance is fragile. Government budgets are balanced or have a moderate deficit, but all countries have a significant deficit in quasi-fiscal transactions.

In 2011, the economic situation in the region was somewhat different from the global trend: despite the overall worsening of the economic situation in the world, the CIS economies managed to speed up their growth to a certain extent. The weighted average GDP growth in the region (in 2011) was 4.6% (compared to 4.2% in 2010). Three economies (Azerbaijan, Belarus and Moldova) had a slower growth than in 2010. The Russian economy, which accounts for 77% of the region's economy, remained at the level of 2010. A noticeable result of 2011 was high growth in agriculture. In contrast, the growth in production slowed down in the majority of the CIS countries because of the increased prices of products and a lower demand for them.

The dynamics of the current accounts were determined, as before, by the effects the favourable situation in the global raw materials markets had on the balances of trade of the countries in the region and, primarily, the first group (exporters of oil and gas). At the same time, increased oil and food prices have worsened the balances of trade in the other two groups, which are primarily importers of oil products. However, in these countries the effect of increased prices of imports was compensated to a certain extent with high prices of their main exports, in particular gold, aluminium and cotton. The growth of the Russian and Kazakh economies had a positive effect on money remittances. The countries that are dependent on transfers to the most significant extent have received additional opportunities to finance their trade imbalances, which had worsened because of increased import prices. Despite the considerable outflow of capital from the economies in the first group, the balance of payments in the region has produced an overall net increase in the reserve assets of central banks.

On one hand, increased export revenues and the revival of economies in the region had a positive effect on budget revenues. On the other hand, these contributed to an insignificant growth in social spending and salaries of government officials, compared to state revenues. Kazakhstan's traditionally well-balanced budgetary policy resulted in a considerable budget surplus in the consolidated budget. Russia's fiscal results were also better than forecasts made in the beginning of the year. In those countries of the region that face chronic public finance deficits and rather high government debt, favourable conditions led to a certain improvement in economic situation.

A lower growth in the world prices of raw materials and food products and tightened (to a certain extent) monetary policies have restrained inflation in all countries of the region. At the same time, Belarus faced an acute crisis in its balance of payments caused by excessive stimulation of domestic demand.

After the devaluation of the Belarusian currency in spring and summer, the government's measures and the urgent assistance from the EurAsEC Anti-Crisis Fund and other donors have significantly stabilised its economy and helped to stop the drastic weakening of the national currency and restrain growth in prices.

The scenario for the nearest years suggests that global imbalances will continue to be eliminated. The growth in developed markets will remain low until the population decreases its debts, which could require several years. In eliminating global imbalances, Western countries with high government or private debt will change the structure of their economies by strengthening export-oriented sectors and reducing consumption. At the same time, the dynamically developing Asian countries – China in particular – will increase their domestic consumption to the detriment of their export potential. This process won't be painless for the West, or for the Asia-Pacific, as the economic correction it suggests is very significant.

However, there are grounds to believe that the global economy will retain insignificant, but stable growth, as a slowdown in the development of certain economic sectors or certain countries will be compensated by accelerated growth in other sectors and countries. The IMF and the World Bank suggest that the economic unevenness of developed and developing countries will gradually be eliminated. According to their recent forecasts<sup>2</sup>, the global economy will have a growth of 2.5–3.5% in 2012, with an insignificant acceleration to 3–4% in 2013–2014. The growth in developing economies will slow down slightly in 2012, and accelerate to 6% on average in 2013–2014, while, in developed countries, it will remain at a relatively low level of 1.4–2.5%. The most probable scenario is that the eurozone authorities will retain control over the situation around problematic countries through debt relief and support of debtors. However, the fear of recurrences of the debt crisis in Europe will continue to affect the world's economic activity.

For the CIS countries this scenario is rather favourable, since Asian developing markets will still demand raw materials. In addition, raw materials prices will be supported by investment demand underpinned by soft monetary policies in the West and the weakness of main reserve currencies, primarily the US dollar, in the nearest years. EDB forecasts that if Brent oil prices remain high (at \$115 per barrel), the region will grow by 4–5% on average in 2012–2013. However, the main risks, which we described above, threaten higher growth rates in the CIS economies. For this reason an alternative scenario has been prepared, which suggests that oil prices will fall to \$90 per barrel on average in 2012 and 2013. This will slow down the growth of the CIS economies to 3.2–3.9%.

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<sup>2</sup> IMF (2012) *World Economic Outlook*, April. World Bank (2012) *Global Economic Prospects*, June.

We have grounds to believe that even in the event of dramatic developments in the world, prices of raw materials won't go down in such a radical fashion and the lending activity of the global financial sector won't stop as it happened after the collapse of Lehman Brothers. A comparison of the current situation in the world and the CIS countries with the situation which had place before the crisis of 2008 suggests that the changes that happened in the last three years did not impact unambiguously the scale of possible negative events and the resistance to them on the part of the countries in the region. The essential differences include the absence of overheating in both the global economy and the economies of the region. Another important factor, which seems to be the most important now, is that the possibilities to support economic growth in the eurozone, with monetary and fiscal policies (monetary policy in particular), have not been exhausted to date.

Therefore, the following realistic scenarios exist which demonstrate the effects of negative developments in the world on the CIS in the nearest years:

1. Debt crisis in the eurozone. The consequences of a default by one or two peripheral eurozone countries (Greece and possibly Portugal) will depend on the measures taken in this situation by European authorities, but we have grounds to believe that these consequences will be moderate. A significant portion of debts of these countries has been de facto already written off by their creditors. In addition, financial institutions that are holders of these debts had sufficient time to form adequate reserves in case of default. For these reasons we have grounds to hope that in a moderately negative scenario, financial markets will continue to function normally and the corporate sector of the CIS economies won't face a sudden discontinuation of access to external funding. Nevertheless, economic damage in this case will be considerable: Europe will be in deep and lengthy recession, which will probably last throughout 2012 and a part of 2013. Prices of all raw materials can be expected to decrease to a certain extent. We can expect that Brent oil prices in this scenario will fall to approximately \$90 per barrel and remain at this level for a year (the level of prices determined by the budgetary situation in Saudi Arabia and marginal oil production costs). The effect this crisis will have on the CIS countries will be significant but not catastrophic: growth rates in the region will remain positive.
2. Financial crisis in China. We can suppose with some certainty that Chinese authorities will manage to avoid the crisis development of the problematic situation in the country's financial sector. We deem the possibility of a financial crisis in China as an additional negative factor in case other negative scenarios develop, primarily the scenario of a large-scale crisis in the eurozone which is described above. China is the world's leading consumer of energy resources, and a slowdown in its economy will result



		Trade with European Union (share, %)	Trade with China (share, %)	Trade with the CIS (share, %)
Exporters of oil products	Azerbaijan	42%	3%	16%
	Kazakhstan	47%	17%	26%
	Russia	47%	9%	15%
	Turkmenistan	20%	21%	
Exporters of labour	Armenia	31%	9%	30%
	Kyrgyzstan	8%	15%	52%
	Moldova	45%	6%	36%
	Tajikistan	6%	34%	
Exporters with a diversified structure of trade	Belarus	25%	4%	55%
	Uzbekistan	16%	16%	
	Ukraine	29%	5%	40%

**Table 7.2.**  
**Geographical  
distribution of trade  
in the CIS countries**

Source: Trademap

in reductions in oil prices. If its growth is slowed down to 4-5% a year, this will be a challenge to all the CIS economies, especially Central Asian economies which are more closely tied to China.

3. Fiscal consolidation in the US. As we suggested above, more or less serious measures to restore budgetary balance in the US will most probably be taken not earlier than in 2013. Earlier consolidation can be provoked by a large-scale crisis in another part of the world, most probably Europe, if because of it investors become less confident about the reliability of the American government's debt obligations.
4. Unexpectedly quick growth in energy and food prices. There is a risk that relatively favourable developments in the world (the renewed growth in Europe and the US and still very soft policies by central banks) will cause an unexpectedly quick rise in raw materials prices instead of their decrease and this can be dangerous for the most vulnerable CIS economies. The CIS countries that are vulnerable to unexpectedly quick growth in food prices are the countries with the highest poverty level, such as Kyrgyzstan and Tajikistan. Both these countries were listed by the UN Food and Agriculture Organisation (FAO) among the countries in danger of food crisis. The situation in this sphere could worsen, as agriculture in these countries depends on oil imports. A drastic increase in oil prices can also damage the CIS countries with high energy consumption which do not have their own significant oil and gas reserves and lack stability in external balance. This can affect Belarus and, although to a considerably lesser extent, Ukraine. In this case, the CIS countries above may need support from neighbours in the region.

The channels, through which external economic events influence the situation in the region, did not change compared to 2008–2009. If oil prices drop, the CIS countries (where raw materials exports play a key role in economy) will suffer reductions in export revenues and narrower access to external funding, which is important to their private sector. Exporters of labour will be affected by lower financial remittances from their citizens who work abroad, primarily in neighbouring countries within the region. On the other hand, a drastic increase in energy prices will impact favourably on the trade surpluses of the net exporters of raw materials and bring additional revenues to state budgets and international reserves of these countries. At the same time, this increase will significantly worsen the balances of trade of oil and gas importers, which will be compensated by increased remittances by labour migrants.

Money remittances are the key mechanism, with the help of which benefits and losses of energy and food exporters, in the event of changes in prices of their exports, are distributed among all countries in the region. Despite all the difficulties, this risk sharing mechanism helps the majority of the CIS countries to mitigate the increasing risks to a certain extent and resist the slowdown in the global economy.

# Monitoring Mutual Investments in CIS Countries

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This paper is based on the monitoring of mutual investments in CIS countries and Georgia (MMI CIS). This research project was conducted jointly by IMEMO and EDB Centre for Integration Studies in 2012. Institute of World Economy and International Relations (IMEMO) between December 2011 and May 2012. Efforts are currently under way to build the Single Economic Space on the basis of the Customs Union of Russia, Belarus and Kazakhstan. This is, of course, not the first attempt at promoting economic integration between post-Soviet states; nevertheless, CIS countries have so far failed to achieve their desired level of regional integration. Scientific studies suggest that the success of “top-to-bottom” integration can only be ensured if the strong prop of corporate integration is already in place (Libman, 2007; Heifetz, Libman, 2008). One of the critical elements of this corporate integration is foreign direct investment (FDI). Without the ongoing monitoring of investment ties it would be difficult to formulate an effective integration strategy for Russia and its CIS partners.

Investor companies in the post-Soviet states represent a very specific type of transnational corporation (TNC). Whilst they have much in common with most other TNCs, these companies have a number of distinct attributes linked to the relative lack of language and other non-economic barriers to investment within the CIS, and to the peculiarities of the post-Soviet business community itself. Moreover, the emerging TNCs in Russia, Kazakhstan, Ukraine and other countries in the region share some features with TNCs from developing countries. Therefore, an analysis of investor companies from the CIS and Georgia supported by a high-quality empirical and statistical database would allow the theoretical notion of TNCs to be widened. In recent years, any significant “geographic” expansion of the empirical base has inevitably prompted new theoretical studies of direct investment (Kuznetsov, 2012).

A clearer picture of cross-border investment ties within the region provided by the MMI CIS exercise will not only benefit consumers in public administration, scientific and expert analysis but also the business community. Companies active in CIS countries have an interest in the availability of proficient consulting services; such consultancy is not generally offered by leading western agencies due to the highly specific nature of FDI in the post-Soviet space. Nevertheless, the combination of a quality information source (database) and professional summary analysis may raise the “eligibility criteria” for foreign competitors who are able to mobilise considerable resources to enhance their presence in CIS countries. This effect has already been observed in the scientific sphere, where professionals from the US and EU have begun cooperating with leading experts from Russia (Kuznetsov, 2010).

MMI CIS has several targets, and this is reflected in the structure of our paper. In Section 1 we discuss flaws in the existing MMI official statistics in CIS countries. Section 2 describes the algorithm of MMI applicable to the CIS. Section 3 describes the geographic structure of accumulated FDI that has emerged from the MMI CIS. Section 4 gives a breakdown of FDI by industry and corporation. Finally, in Section 5, we suggest ways of applying MMI CIS on a wider scale.

## **1. FLAWS IN THE OFFICIAL STATISTICS ON MUTUAL INVESTMENT IN CIS COUNTRIES**

Despite many attempts by international organisations to standardise FDI statistics (e.g., the introduction of a 10% threshold to distinguishing between direct investment and portfolio investment), there are still features which are peculiar to the CIS countries and Georgia:

- coverage of investment projects (especially small ones);
- method of calculating accumulated FDI;
- establishing the “nationality” of FDI;
- inclusion of reinvestments in existing foreign projects.

The most comprehensive assessment of FDI flows can be obtained from balance of payment statistics which are normally published by national central banks. However, these central bank publications rarely provide sufficient detail on the industry or geographic structure of investment. In Russia, FDI statistics are available from the Central Bank (CB) and Rosstat (the national statistics agency); the latter relies on surveys completed by investor companies (Kuznetsov, 2009). However, not all companies readily supply the information requested on the Invest-1 form.

There is no perfect method of calculating accumulated FDI. Due to high inflation rates (especially in CIS countries), calculations based on historic prices result in lower FDI figures for periods in the past compared with more recent years. Any

calculation based on market prices is complicated by the fact that CIS stock markets are less well developed (i.e., most companies' securities are not traded on stock exchanges on a large scale). There are also problems linked with rapid fluctuations in asset values (especially during the last global crisis), subjective estimates of value, and a variety of other factors.

Another problem is the inclusion in FDI statistics of long-term loans provided by parent companies to their overseas subsidiaries (e.g., by a Russian TNC to its branch in Ukraine). The repayment of such loans, especially interest-bearing ones, in some instances results in negative accumulated FDI figures. Yet a project implemented using such loans may continue to function successfully under the control of the same foreign company.

Therefore, despite claims that cross-border investment statistics have been standardised between different countries, we should bear in mind that any quantitative assessment of accumulated FDI is merely an approximation. Even statistics from the UNCTAD, the leading international agency on FDI studies, can only partly illustrate the proportion of total FDI contributed by specific investor countries. In the region studied, the indisputable lead exporter of capital is Russia, and the other prominent players are Kazakhstan, Ukraine and Azerbaijan (see Table 8.1). FDI by Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan is negligible by comparison.

International comparisons are complicated even further by differences in the time taken to calculate accumulated FDI in different countries. As a rule, the more investment companies from a particular country make, the more time it takes the central bank or other body in charge of FDI statistics to collect, process and verify the data. As a result, international statistics on such countries

Country	Accumulated exported direct investment (\$ million)	Accumulated imported direct investment (\$ million)
Azerbaijan	5,790	9,593
Armenia	85	4,206
Belarus	205	9,940
Georgia	155	7,821
Kazakhstan	16,176	81,352
Kyrgyzstan	1	974
Moldova	68	2837
Russia	433,655	423,150
Tajikistan	...	915
Turkmenistan	...	8,186
Uzbekistan	0	4,460
Ukraine	7,966	57,985

**Table 8.1.**  
Accumulated  
exported and  
imported direct  
investment in CIS  
countries and  
Georgia as at late  
2010

Source: UNCTAD,  
2011: 194

may be based on incorrect preliminary estimates. In Russia, for example, the UNCTAD relies exclusively on data supplied by the Russian Central Bank, but it receives this data from the CB for preparing its annual FDI reports in spring, whereas the CB publishes its final data only in summer.

As a result, at the end of 2010 UNCTAD's figures showed \$433.7 billion of accumulated Russian FDI, whereas the CB showed only \$368.7 billion (in fact, the latter figure was used for international comparison by the IMF which prepared its report later than the UNCTAD). Both the IMF and the UNCTAD also show different data on Kazakhstan and Armenia (see Tables 8.1 and 8.2).

The official CIS statistics clearly reflect the "neighbourhood effect" in FDI geography, which is more pronounced in countries with insignificant capital export volumes (see Table 8.2). Whereas in Russia, according to official statistics, only 4.4% of all accumulated overseas direct investment was made in the CIS, the respective proportion is 10.9% in Kazakhstan, 46% in Azerbaijan, and as much as 90.7% in Belarus.

The main recipients of FDI from Kazakhstan are Russia and Kyrgyzstan, and Georgia receives nearly the same amount of Kazakh capital as Ukraine. The

**Table 8.2.**  
The geography  
of accumulated  
direct investment  
of CIS countries  
as at late 2010

Source: IMF, 2010

Recipient country	Accumulated direct investment (\$ million)					
	Russia	Kazakhstan	Azerbaijan	Belarus	Armenia	Kyrgyzstan
<b>Total</b>	<b>368,737</b>	<b>15,682</b>	<b>5,790</b>	<b>205</b>	<b>83</b>	<b>2</b>
Azerbaijan	17	8	–	0	0	0
Armenia	1,753	10	0	0	–	0
Belarus	5,702	39	0	–	0	0
Georgia	290	162	2,578	0	0	0
Kazakhstan	2,036	–	26	1	0	0
Kyrgyzstan	106	257	0	0	0	–
Moldova	387	1	0	0	0	0
Russia	–	891	44	156	6	0
Tajikistan	264	44	0	0	0	1
Turkmenistan	173	1	0	0	0	0
Uzbekistan	991	127	0	0	0	0
Ukraine	4,333	166	13	29	0	0
<b>Total, 12 post-Soviet countries</b>	<b>16,052</b>	<b>1,706</b>	<b>2,661</b>	<b>186</b>	<b>6</b>	<b>1</b>
Cyprus	153,934	496	0	0	0	0
The Netherlands	39,668	9,228	68	0	0	0
British Virgin Islands	38,762	687	0	0	0	0
The UK	10,278	2,433	18	0	0	0
The US	9,825	599	15	1	0	0

lion's share of Azerbaijan's FDI in the CIS flows into Georgia. The other main recipients of Azerbaijan's FDI are Russia, Kazakhstan and Ukraine. For Belarus, the main destination of export capital is Russia, and neighbouring Ukraine also receives significant volumes of FDI.

The above data confirms the theoretical conclusion that the overseas expansion of national businesses slowly moves beyond the familiar cultural and business environment of neighbouring countries (Kuznetsov, 2008a). The low percentage figure for Armenia partly fits this logic, since an "occasional" investment project implemented outside the neighbouring countries may be of great significance in the context of the country's small FDI volumes.

However, much more serious misrepresentations occur in connection with transshipping FDI via third countries such as Cyprus, the Netherlands, British Virgin Islands, etc. (in some cases such jurisdictions are used for round-tripping FDI, e.g., Russia – Cyprus – Russia). This issue has been addressed in other research papers (Pelto, Vahtra, Liuhto, 2003; Heifetz, 2009), and MMI CIS provides a wider empirical base for further studies. In particular, one of the large projects included in the MMI CIS database (with authorised capital of about \$577 million) is the 100% control of Russian Alfa Bank over Alfa Bank Ukraine exercised via ABH Ukraine Ltd. of Cyprus. Another example from the series is Atomredmetzoloto (a structural branch of Rosatom) which controls uranium mining and enrichment assets in Kazakhstan with a value exceeding \$1 billion via Uranium One Inc. of Canada.

Other CIS countries also use third-country jurisdictions. This phenomenon can be seen most clearly in the official Ukrainian FDI statistics, which requires special arrangements for monitoring mutual investment in the CIS. Over 90% of Ukraine's accumulated FDI is formally concentrated in Cyprus (see Table 8.3).

Recipient country	Accumulated direct investment as at late 2010		Accumulated direct investment as at late 2011	
	\$ million	%	\$ million	%
<b>Total</b>	<b>6,871.1</b>	<b>100</b>	<b>6,898</b>	<b>100</b>
Cyprus	6,342.5	92.3	6,342.1	91.9
Russia	194.3	2.8	236.5	3.4
Latvia	87.9	1.3	80.4	1.2
Poland	49.1	0.7	48.2	0.7
Georgia	31.1	0.5	32.7	0.5
British Virgin Islands	25.8	0.4	25.8	0.4
Kazakhstan	25.2	0.4	24.5	0.4
Others	115.2	1.6	107.8	1.5

**Table 8.3.**  
The geography  
of Ukrainian  
direct investment  
accumulated abroad  
(share capital)

Source: Ukrstat,  
2011

In Kazakhstan, the situation is somewhat different: large volumes of Kazakh capital flow via the Netherlands and the UK (indeed, foreign investment from Russia and other CIS countries often reaches Kazakhstan via third countries). The proportion of investment transacted via Cyprus is not significant (see Table 8.2).

In Section 2 we demonstrate that, once the “transshipment” of capital used for many projects is detected by means of MMI CIS, the geographic distribution of FDI differs dramatically from that officially recorded in post-Soviet states. It is unlikely that official bodies in the CIS countries and Georgia are prevented from recording FDI both at the location of initial investment and final destination by any legal or methodological barriers. To date, the Federal Bank of Germany (Deutsche Bundesbank) and other overseas agencies have separately published information on the geographic distribution of so-called unmediated and mediated direct investment. In this context, in the case of CIS countries, it becomes more relevant to discuss the increasing volumes of registered mutual FDI, including mediated investments, since CIS countries themselves rarely act as “transshipment bases” for investing outside the post-Soviet space.

Another material discrepancy between the official statistics and MMI CIS data arises due to the inclusion of investment in project expansion and modernisation. This raises an important methodological question: whether or not FDI should include the reinvesting of profit generated by overseas subsidiaries. Where a researcher is interested primarily in the financial aspects of direct investment, reinvested profit does not need to be included, since it has nothing to do with balance of payments statistics. But where research is focused on the general role FDI plays in an economy, regional integration, technology transfer or other positive cross-border process, it is necessary to record not only cross-border movement of capital but also total investment by a particular foreign company. After all, profit may have been transferred by a TNC to its home country without being reinvested, and then the TNC may have returned to invest the same sum. Or, for example, cross-border capital movement recorded in balance of payments statistics may represent merely a formal exchange of shares without any money actually being invested.

In practice, the expansion of a foreign investor’s business presence rarely takes the form of classic FDI. A notable exception to this rule in the CIS was Gazprom’s acquisition of control over Beltransgaz in Belarus, which was concluded by transferring funds across the border each time it became necessary. But typically, especially in the CIS, initial investment in assets is much smaller than subsequent investments in modernisation and expansion. In the case of privatisation transactions in Central Asia, foreign investors are often brought in not as part of an attempt to raise funds by selling a state-owned company, but in order to make former Soviet assets competitive internationally, which is often impossible without the participation of a powerful TNC (Kuznetsov, 2008b).



Some experts even maintain that the division of FDI transactions into greenfield and merger-and-acquisition (M&A) categories is largely notional. In many instances FDI has a transitional "brownfield" format, where a purchased asset is fundamentally modernised or expanded. Russian telecommunications companies, the majority of fuel and energy companies, and players from other industries, took this route in almost all CIS countries. Projects of this type also include certain banking investments, where a foreign subsidiary bank multiplies its authorised capital by diversifying and expanding its business in the country.

As with estimates of the number of ultimate recipients of FDI made via third countries, public statistics agencies in all CIS countries and Georgia would collect and publish FDI data both with and without reinvested profit. Figures for such international transactions are available. But to date, MMI CIS fills the gap in the post-Soviet space.

## 2. THE MMI ALGORITHM

Previously published research papers on Russian TNCs did of course include lists of projects in CIS countries. However, such publications were not regular. The only exceptions are internet publications by the Turku Pan-European Institute (e.g., Vahtra, 2005) and B.A.Heifetz from the Institute of Economics of the Russian Academy of Sciences (beginning with the monograph by Libman and Heifetz, 2006). In addition, many publications focus principally on large projects (e.g., Kuznetsov, 2007). The exceptions are papers on Russian FDI in particular CIS countries (Chetverikova, 2009; Blyakha, 2009; Yeremeyeva, 2009, and others). In many cases the value of a vast database provided in a paper is somewhat diminished, as these databases contain only project titles and start dates without any attempt to assess, even approximately, the amount of FDI (Heifetz, 2011b; Heifetz, 2001c). The number of quality publications covering FDI by companies from other CIS countries can be counted on the fingers of one hand, and they deal mostly with Ukrainian and Kazakh TNCs (Kononov, 2010; Amagoh, Markus, 2010). Some useful information can be derived from research publications on particular industries (e.g., Vinokurov, 2009) and large businesses from selected countries (Yezhednevnik, 2012).

Since most companies do not publish their FDI statistics, MMI CIS has to rely on various indirect indicators to estimate FDI amounts. Typically, any missing data on FDI are substituted with cross-border M&A costs (Vahtra, 2009, Kalotay, Sulstarova, 2010). The main weakness of this method is that it results in a bias towards one form of FDI (M&A) without due attention to greenfield FDI or investment in expansion and modernisation of acquired companies (brownfield FDI). An approximate, but often the only substitute for data on accumulated FDI by industrial TNCs is data on capital (non-current) assets (Kuznetsov, 2009). For banks, the most accurate indicator is their authorised capital (which in principle is the key element of FDI). Since financial institutions are subject to stricter requirements, the increase of authorised capital generally reflects the extent

of overseas expansion of the relevant banking groups. In the case of transport companies, as a rule, it is very difficult to obtain FDI statistics even on long-term assets, nevertheless the nature of the investors' fleet of aircraft, rail cars or vessels is well known and its value can easily be estimated. Comparison with the published costs of similar projects may also be utilised in estimating investment in construction, provided that the projects in question are fairly standard.

The information search algorithm also has some distinctive features. To build an initial database, it was necessary to decide upon a list of target companies to be included in the MMI CIS exercise on a regular basis in order to detect new investment in the overseas expansion of relevant TNCs (be it additional FDI in existing assets or geographic expansion). In addition, we had to identify the most valuable sources of information, mainly on the internet, for identifying new acquisitions and greenfield projects.

On the whole, the MMI CIS algorithm can be divided into the following six steps:

- examining the websites of leading Russian companies, firstly those on the Expert-400 list (Expert, 2011), and the most prominent companies and business groups in other CIS countries;
- monitoring news of FDI issued by companies from CIS countries and Georgia;
- examining business and scientific publications (with varying levels of coverage, from Belarusian projects in Smolensk Oblast to corporate integration in the context of the CIS as a whole);
- verifying all collected data on FDI using the companies' financial statements, reports and press releases;
- if no such data are available, calculating the above indirect indicators and/or checking them against other data (particularly Rosstat data on direct investments from CIS countries in Russia's regions and industries); and
- commissioning an independent expert to verify the data obtained.

One of the key decisions for monitoring was where to set the minimum size of project investment for inclusion in the database. Clearly, information on smaller investment projects often escapes the attention of the mass media. The relevant investing companies are themselves less likely to publicise their activities (due to their small size, among other things), and in the case of large TNCs such projects seem negligible in the context of their larger FDI transactions. Therefore, many foreign statistical agencies introduce minimum reporting thresholds for direct investors which, however, vary greatly between countries. For example, in the mid-2000s this threshold ranged across the EU from \$3,000 in Estonia and \$12,000 in Denmark to \$10 million in Finland and

\$13 million in the Netherlands. Some countries, particularly Germany, increase the minimum size of "eligible" FDI on a regular basis (Kuznetsov, 2008). The introduction of alternative forms of monitoring implicitly limits opportunities, since they do not always include companies that have a high response rate to their inquiries. Therefore, for example, the Russian magazine Mergers and Acquisitions set a minimum threshold of \$5 million for its database of Russian company transactions (including cross-border ones).

When launching the MMI CIS exercise, we set an initial minimum interval of \$1-\$10 million. We then found empirically that changes in the reliability of collected data occur at a level of about \$3 million, and this figure was selected as the minimum threshold. It should be stressed that in many cases FDI estimates can be accurate to within \$10 million.

However, one-third of projects in our database are smaller in scale. At later phases of MMI CIS, such projects will assist us in addressing the following three tasks:

- following up promising projects which were initially included in the database in their early stages. For example, Zarubezhneft and Itera intend to invest up to \$6 billion in fossil fuel production in Block-21 in Turkmenistan, but so far only relatively low-cost geological exploration has been carried out;
- monitoring industries which are important to post-Soviet integration but in which large-scale investment is extremely rare. The sector which perhaps best illustrates this is higher education: there are 37 branches of Russian universities throughout the CIS, but the largest investment ever made in this industry was the \$5 million received by the Sevastopol Branch of the Lomonosov Moscow State University; and
- collecting information on small projects, including those implemented by smaller investor countries or in border regions, to assess whether there is a need to lower the selected threshold in the future (at least for individual project categories).

The database on investment projects in CIS countries and Georgia built by the IMEMO research team principally contains information on accumulated FDI as at the end of 2011 or indirect statistical indicators which may indicate FDI volumes. It contains a total of 602 transactions or greenfield projects, but two transactions do not formally qualify as direct investments (large production projects with a stake of less than 10%). Six of these transactions were made in unrecognised or partially recognised republics (Abkhazia, South Ossetia and Nagorno-Karabakh); these autonomous republics are economically isolated from the respective countries (i.e. Georgia and Azerbaijan). In addition, the database contains information on 56 relatively significant transactions or projects which had been terminated by 2012 (the companies were sold to

national investors or TNCs from third countries, and the greenfield projects were wound up). Another 12 transactions were embarked upon by independent Russian companies but then the investors themselves came under the control of TNCs from third countries (typically, from the EU).

In total, MMI CIS covered 526 mutual investment projects which were active at the end of 2011 (two of these with investors from two CIS countries). Of these, 96 projects had accumulated direct investment of \$100 million or more (including one Russian-Kazakh project), and 185 transactions involved investments not exceeding \$3 million. Official information or fairly reliable estimates of accumulated FDI are available for about half these projects.

### 3. THE IDENTIFIED GEOGRAPHY OF MUTUAL DIRECT INVESTMENT IN CIS COUNTRIES AND GEORGIA

Although Russia accounted for only 74% of the projects in the MMI CIS which were active at the end of 2011, that country's proportion of large projects was 79%, and its share of total mutual FDI reached nearly 87% (see Table 8.4). By contrast, Armenia, Belarus, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan and Uzbekistan had no large projects, and Georgia had one project which was a very specific case. Georgia's only known billionaire, B. Ivanishvili, gave up Russian citizenship and started to sell off his large assets in Russia (including Rossiysky Kredit Bank). However, by the end of 2011 he still had two companies to dispose of, Stoilenskaya Niva and Doktor Stoletov.

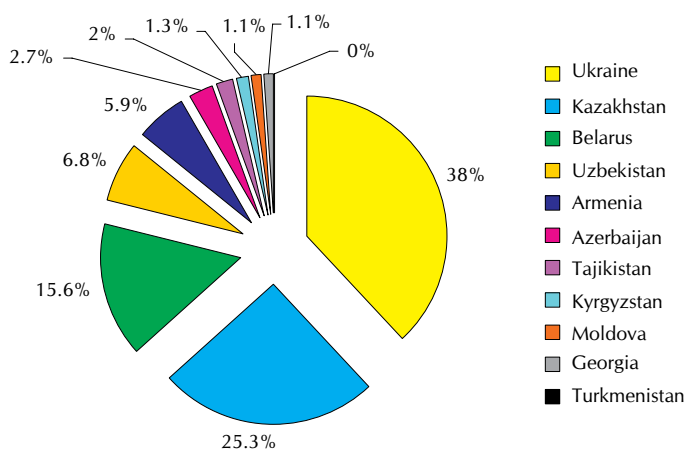
**Table 8.4.**  
Projects involving  
direct investment  
in CIS countries  
and Georgia  
(as at late 2011)

Source: MMI CIS

Investor country	Total number of projects	Number of projects with direct investment of \$100 million or more	Number of projects with direct investment not exceeding \$3 million	Total direct investment (\$ billions)
Azerbaijan	9	2	0	1.38
Armenia	4	0	3	0.01
Belarus	42	0	36	0.18
Georgia	8	1	2	0.41
Kazakhstan	41	13	3	4.26
Kyrgyzstan	3	0	2	0.03
Moldova	3	0	3	0
Russia	391	76	127	47.94
Tajikistan	1	0	1	0
Turkmenistan	1	0	1	0
Uzbekistan	2	0	1	0.01
Ukraine	23	5	6	1.15
<b>Total 12 countries</b>	<b>526 (2 – two countries)</b>	<b>96 (1 – two countries)</b>	<b>185</b>	<b>55.37</b>

Russia naturally dominates not only due to its economic and geopolitical weight in the post-Soviet space, but also due to its powerful TNCs. Russian TNCs are diverse and often owe their success to their strength in Soviet times or to other factors which are specifically Russian (Kuznetsov, 2007). Some Russian TNCs (e.g., those in the telecommunications sector) rose to prominence by serving the domestic market on the "catching-up development" model. But many other TNCs were able to exploit rich natural resources or operated competitive Soviet production assets (in the first case Russia has much in common with Kazakhstan and Azerbaijan, and in the latter case with Ukraine).

In analysing the geography of Russian FDI in the region, Ukraine's position as the leading recipient (see Figure 8.1) is notable. Due to their geographic and cultural proximity, the strong influence of inherited Soviet-era value-added chains and other factors, doing business in Ukraine remains the most attractive option for many Russian companies. In terms of accumulated Russian FDI, Ukraine is some way ahead of Russia's partners in the Customs Union. Of the smaller countries, Armenia takes the lead for geopolitical reasons.



**Figure 8.1.**  
The geographic  
distribution of  
accumulated Russian  
direct investment in  
CIS countries and  
Georgia

Source: MMI CIS

Russia receives large amounts of FDI from other CIS countries. There are, however, serious discrepancies between Russian Central Bank and MMI CIS data (see Table 8.5). Firstly, the MMI CIS database understates the contributions of Armenia, Azerbaijan, Moldova and Central Asian countries (except Kazakhstan) to FDI in Russia, as well as the total accumulated FDI figures. This may be explained by the omissions in the recording of small projects, especially those owned by ethnic communities in Russia. Technically, it is very difficult to identify Tajiks or Armenians, for example, among investors who may or may not hold Russian passports. For the same reason (i.e., a billionaire Georgian without a Russian passport) Georgia's share of FDI in Russia was overstated.

More interesting, in our opinion, is the data on the larger investor countries – Kazakhstan, Ukraine and Belarus. In all cases, MMI CIS' total FDI figures are much higher than those of the Russian Central Bank (four times higher in the case of Ukraine) (see Table 8.5). This confirms our hypothesis that, just as Russian companies invest in Ukraine via offshore jurisdictions, Ukrainian companies also invest in Russia via third countries. A similar situation is observed in Kazakhstan. In the case of Belarus, however, the main reason for the discrepancy is inadequate recording of investment projects by official bodies.

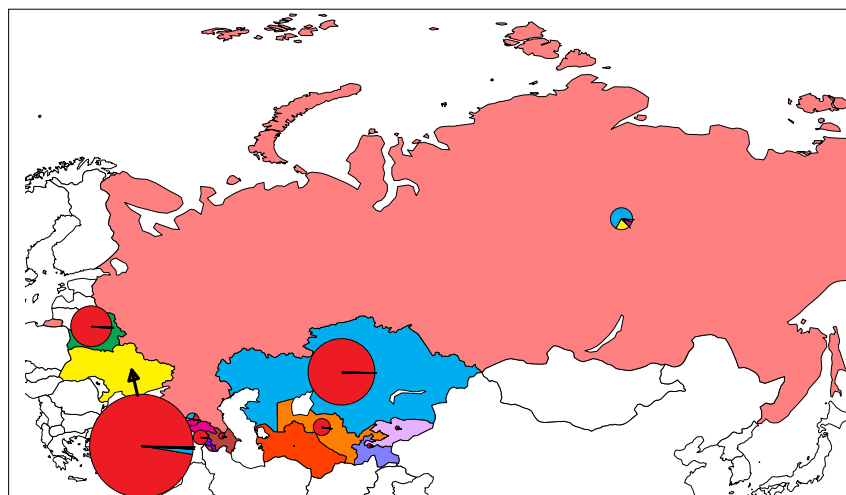
**Table 8.5.**  
**Accumulated FDI**  
**in Russia, by country**

Source: Direct  
Investment in the  
Russian Federation  
as at January 1, 2010  
and January 1, 2011  
(<http://www.cbr.ru>);  
MMI CIS

Investor country	Accumulated FDI in early 2011, according to the Russian Central Bank		Accumulated FDI in 2011, according to MMI CIS	
	\$ billion	%	\$ billion	%
Azerbaijan	0.32	15.3	0.04	0.9
Armenia	0.18	8.6	0	0
Belarus	0.08	3.8	0.16	3.7
Georgia	0.01	0.5	0.33	7.7
Kazakhstan	1.12	53.6	2.84	66
Kyrgyzstan	0.08	3.8	0	0
Moldova	0.01	0.5	0	0
Tajikistan	0.01	0.5	0	0
Turkmenistan	0	0	0	0
Uzbekistan	0.03	1.4	0.01	0.2
Ukraine	0.25	12	0.92	21.4
Total	2.09	100	4.3	100

Generally, since investment by other CIS countries in Russia is no match for Russian investments in those countries, mutual direct investment is less significant for Russia than for other countries. Russia is the key investor in all CIS countries except Georgia, where Azerbaijan and Kazakhstan clearly dominate (see Figure 8.2). However, many experts maintain that the successful development of any integration group is determined principally by economic interaction between smaller member countries circumventing the leader (we would draw an analogy here with the NAFTA, in which Mexican-Canadian contacts traditionally act as benchmarks).

In some cases the largest investor pairs without Russian participation illustrate the neighbourhood or territorial closeness effect in a wider context (see Table 8.6). There are, however, other pairings which are not so geographically proximate, e.g., Kazakhstan – Ukraine or Georgia – Belarus. Importantly, there are no politically motivated alliances (as with the GUAM initiative). For example, PrivatBank of Ukraine made considerable investment in Georgia



**Figure 8.2.**  
The map of direct  
mutual investment  
in CIS countries and  
Georgia

Source: MMI CIS

The size of the circles is directly proportional to the volume of accumulated direct investment of the countries

Direct investments:



(the authorised capital of its subsidiary is \$13 million); in parallel with this, PrivatBank founded Moskomprivatbank whose authorised capital has already reached \$50 million. A further example is the Bank of Georgia, which attempted to augment its presence not only in Belarus but also in Ukraine. However, it eventually had to sell off a large proportion of shares in its Ukrainian subsidiary due to its poor profitability.

Investor country	Recipient country	Accumulated FDI (\$ billions)	Company with the largest FDI volume
Azerbaijan	Georgia	1.25	SOCAR
Kazakhstan	Georgia	0.61	Kaztransgaz
Kazakhstan	Kyrgyzstan	0.37	Kazakhmys
Kazakhstan	Ukraine	0.32	BTA Bank
Ukraine	Georgia	0.16	Privat
Azerbaijan	Ukraine	0.09	SOCAR
Ukraine	Moldova	0.06	Kviza Trade
Georgia	Ukraine	0.05	Borjomi
Georgia	Belarus	0.03	Bank of Georgia
Kyrgyzstan	Uzbekistan	0.03	No accurate data available

**Table 8.6.**  
The largest FDI pairs  
in the post-Soviet  
space not involving  
Russia

Source: MMI CIS

In our opinion, therefore, there are no grounds for claiming that there is an economic basis for political integration that does not include Russia. Even the projects of the SOCAR (State Oil Company of the Azerbaijan Republic) which principally are in Georgia and Ukraine, are driven by ordinary economic logic: in Central Asia or Russia the leading Azeri oil and gas producer would have faced far more aggressive competition from Russian, Kazakh and leading international TNCs.

#### 4. KEY INDUSTRIES AND INVESTOR COMPANIES

The MMI CIS database facilitated a much greater understanding of the structure of mutual direct investment by industry, since official statistics, for reasons of confidentiality, do not provide details of individual investor companies. The largest investment projects were implemented by companies from Russia which belong to the group leading Russian non-financial TNCs in terms of overseas assets (Kuznetsov, 2011). Of the 25 largest projects, only three were implemented by investors from other CIS countries (see Table 8.7). In Azerbaijan, there was a joint project involving Azerbaijan Railways and the State Oil Fund of Azerbaijan (SOFA), which, among other things, exemplifies a particular type of FDI, i.e., a privileged loan for 25 years to a subsidiary joint venture. In Kazakhstan, the investors were development companies rather than classic TNCs.

**Table 8.7.**  
The largest  
investment projects  
in the MMI CIS  
database

Source: MMI CIS

Note: Mechel, RUSAL, VEB and VS Energy implemented projects which do not correspond to their core business

Investor	Home country and industry	Recipient country and project	Approximate FDI (\$ million)	Inception year	Project type
Gazprom	Russia, gas transportation and sale	Belarus, Beltransgaz	5,000	2007	Phased purchase
MTS	Russia, telecommunications	Ukraine, MTS Ukraine	3,000	2003	Purchase, expansion
VypelCom	Russia, telecommunications	Ukraine, Ukrainskiye radiosistemy	3,000	2005	Purchase, expansion
LUKOIL	Russia, oil and natural gas production	Kazakhstan, participation in several PSAs	2,639	1995	Series of purchases, expansion
Evrz	Russia, steel production	Ukraine, Petrovsky Evraz DMZ and other facilities	2,111	2008	Purchase
LUKOIL	Russia, oil and natural gas production	Uzbekistan, several PSAs	1,710	2004	Greenfield, purchase, expansion
VypelCom	Russia, telecommunications	Kazakhstan, Kar-Tel	1,500	2004	Purchase, expansion
Mechel	Russia, non-ferrous metals production	Kazakhstan, Voskhod-Khrom	1,300	2008	Purchase
RUSAL	Russia, coal production	Kazakhstan, Bogatyr-Komir	1,000	2007	Merger



Investor	Home country and industry	Recipient country and project	Approximate FDI (\$ million)	Inception year	Project type
VEB	Russia, production of cast iron, ferroalloys, steel, rolled metal and coke	Ukraine, Industrialny Soyuz Donbassa	1,000	2010	Purchase
Atomredmetzoloto (Rosatom)	Russia, uranium production and enrichment	Kazakhstan, Betpak Dala	928	2009	Purchase
Gazprom	Russia, gas processing and sale	Kazakhstan, KazRosGaz	887	1990-e	Greenfield
Azerbaijan Railways, SOFA	Azerbaijan, railways	Georgia, Kartsakhi-Marabda	775	2007	Construction, reconstruction
VS Energy	Russia, steel production	Ukraine, Dneprospetsstal	750	2007	Purchase
MTS	Russia, telecommunications	Belarus, Mobilnyie Telesistemy	725	2002	Greenfield
Atomredmetzoloto (Rosatom)	Russia, uranium production and enrichment	Kazakhstan, Karatau	720	2009	Purchase
Capital Partners	Kazakhstan, construction	Russia, Metropolis	700	2006	Greenfield
Bulat Utemuratov	Kazakhstan, hotel business	Russia, Ritz-Carlton hotel	700	2011	Purchase
VTB	Russia, banking	VTB Bank (Ukraine)	674	2006	Purchase, expansion
TNC-BP	Russia, oil refining	Ukraine, LINIK	650	2000	Purchase, modernisation
VEB	Russia, banking	Ukraine, Prominvestbank	643	2009	Purchase
VympelCom	Russia, telecommunications	Armenia, Armentel	600	2006	Purchase, expansion
Alfa Bank	Russia, banking	Alfa Bank (Ukraine)	577	2001	Purchase, expansion
LUKOIL	Russia, oil and natural gas production	Azerbaijan, Shakh-Deniz project	574	1996	Greenfield, PSA
INTER RAO EES	Russia, power	Tajikistan, Sangtuda-1 Hydropower Plant	550	2005	Greenfield

Our study confirms foreign experts' view that TNCs from CIS countries other than Russia are immature (Kononov, 2010; Amagoh, Markus, 2010). However, there are several companies which have portfolio production assets in more than one country in the region, i.e., the Minsk Tractor Works (which has assembly plants in Russia, Azerbaijan, Kyrgyzstan and Ukraine, and a facility which it licences in Kazakhstan), and a number of Kazakh banks.

The general structure of FDI by industry is largely shaped by the parameters of Russian FDI, which have been well documented to date (Heifetz, 2011a;

Kuznetsov, 2011). Accordingly, the results of MMI CIS are most interesting from the perspective of FDI in industry by other CIS countries and Georgia (see Table 8.8).

Industries	Direct investment by Russia (\$ billion)	Direct investment from other CIS countries and Georgia (\$ billion)	Total direct investment (\$ billion)
Telecommunications	10.79	0.1	10.89
Production of oil and natural gas	6.19	–	6.19
Transportation and sale of gas	5.62	0.34	5.96
Production of cast iron, ferroalloys, steel, rolled metal and charred coal	4.15	0.12	4.27
Banking	3.29	0.87	4.16
Power	3.17	–	3.17
Production of non-ferrous metals including gold	2.54	0.05	2.59
Production and enrichment of uranium	2.34	–	2.34
Oil refining	1.65	–	1.65
Petrol stations	1.49	0.16	1.65
Coal production	1	0.4	1.4
Railways	0.28	1.1	1.38
Hotel business	0.6	0.76	1.36
Production of chemicals including polymeric pipes	0.62	0.28	0.9
Processing and sales of gas	0.89	–	0.89
Retail trade	0.82	0.06	0.88

**Table 8.8.**  
**The key recipients of direct investment**

Source: MMI CIS

Some industries which are important to Russian TNCs, for example, oil and natural gas, power, etc., are not as attractive to other countries in the region, even when they are highly developed in these countries themselves. Ferrous and non-ferrous metallurgy also receive small amounts of FDI. By contrast, nearly 21% of all the region's mutual investment in banking was made by non-Russian banks, which rather indicates the weak competitive position of Russia's banks compared to its industrial TNCs. The same is true of the Russian hotel industry, which has so far failed to attain the high standards set by its overseas counterparts. Data on railways and chemical production are not worth comparing, since there is only one large project in each of the industries and the figures are high.

There are over 50 incomplete projects in the MMI CIS database; these can be divided into the following categories:

- projects representing failed attempts at overseas expansion (e.g., branches of private Russian universities);
- assets which were sold off as a result of business restructuring in particular countries (e.g., large blocks of shares in Ukrainian power companies owned by K. Grigorishin, a Russian citizen);
- projects aimed initially at establishing a long-term presence in a country but which were terminated for economic or political reasons (e.g., MTS in Turkmenistan or Vimm-Bill-Dann in Uzbekistan);
- parent investor companies which have been sold off because of financial problems (bankruptcy) (e.g., the conglomerate owned by the Kazakh businessman M. Ablyazov, Soyuz-Viktan of Ukraine, which produces alcoholic drinks, and the Russian scrap-processing company MAIR).

One additional category which should be mentioned involves Russian companies which were bought by investors from third countries as a foothold in the CIS from which to launch further expansion.

## 5. POSSIBLE SCIENTIFIC AND PRACTICAL APPLICATION OF MONITORING

The interesting results achieved by the MMI CIS to date appear to merit expansion of this project beyond the post-Soviet space. This would involve the identification and resolution of new scientific tasks and the widening of the FDI monitoring system itself.

FDI has been playing a prominent role in most developed economies for decades, and now there are numerous databases of various types on cross-border investment projects. At the national level, the initial basis for many databases is provided by statutory registration procedures, including registration of companies with foreign capital (Adelkhanyan, 2012). Companies thus registered are subject to frequent surveys, one-off inquiries and other information-gathering exercises on which official FDI statistics rely. Such information is very rarely published "project by project" for confidentiality reasons, yet there are precedents for this. In Poland, for example, until the mid-2000s the State Agency on Foreign Investment published information on all projects with FDI exceeding \$1 million (according to poll data) and estimates of smaller projects twice a year. Although this data was not official (since it was collected by other bodies), it was greatly valued by experts for its quality and prompt availability (IIEPS, 2006).

Commercial databases on cross-border projects are much more diverse. The most internationally renowned databases are Thomson Reuters and Thomson ONE Banker (for mergers and acquisitions) and FDI Intelligence (Financial Times Ltd.) (for greenfield projects). The analytical department of the British newspaper the Financial Times uses unverified news from the mass media. However, the prompt supply of data coupled with a clever PR campaign which

created the idea of this being a valuable resource (its website carries examples of well-structured and colourfully presented information on FDI by country, industry and company) enabled it to sell this relatively poor quality product to consumers (detailed examples on Russian TNCs: Kuznetsov, 2010).

There are several highly specialised monitoring projects, mainly on FDI relating to mergers and acquisitions. Examples include databases on all significant FDI for a particular country both as a recipient and source of investment (e.g., the Russian database of the Mergers and Acquisitions magazine) to databases on FDI by one country in another (Thilo Hanemann, for example, monitors Chinese M&A in the US on a weekly basis at [rhgroup.net](http://rhgroup.net)).

There is a separate category for projects which monitor FDI in integration groups. Arguably the most prominent is Ernst & Young's European Investment Monitoring, launched in 1997. This database already contains information on over 40,000 projects and was compiled by Oxford Intelligence. The project monitors news stories and the information obtained is checked against reports from relevant companies. Because it employs multilingual experts, the project can efficiently monitor cross-border investments throughout the EU. Such monitoring yields, among other things, regular and highly authoritative analytical publications (Ernst & Young, 2011). In other regions of the world this type of monitoring is not used – possibly because integration processes are not as intense in those regions. However, the potential for such projects does exist. For example, the Asia Pacific Foundation of Canada monitors, on a monthly basis, mutual investments by Canada, Australia and Southeast Asia, and its findings, unlike many others, are all publicly available at <http://www.asiapacific.ca>.

MMI CIS can find its niche in this market. It was originally tailored to fulfil a wide range of tasks, including analytical support for regional integration in the post-Soviet space and to improve the scientific understanding of TNCs. This makes MMI CIS different from many other products created to provide consulting services primarily to large businesses or to formally register foreign investment.

The need to process information on TNCs from Russia and other CIS countries via a single project raised several important questions. Firstly, what types of investor companies tend to emerge in former socialist countries, what transformation processes do they undergo, and can the increasing presence of classic TNCs be viewed as a universal trend? Secondly, as the empirical base grows (this time due to other CIS countries, not Russia), it is necessary to clarify once again the factors that shape the scope and industrial structure of exported direct investment. Thirdly, the growing integration of the Customs Union countries calls for renewed scrutiny of interaction between formal integration and corporate integration. The presumption is that even more questions will arise in the course of MMI CIS.

Even now it is clear that FDI in the region corresponds to the key theoretical notion that foreign economic relations tend to be secondary to the processes taking place in national economies. This relates both to the proportions of CIS countries' capital export and its structural parameters. Russia's domination of mutual FDI is apparently unavoidable due to its economic weight and proliferation of true TNCs. It is remarkable that other important investor country pairs in the region are motivated by the "neighbourhood effect" which is more traditional in the geography of FDI than it is in other political initiatives (GUAM, etc.). The industry structure is dominated by traditional specialisations (primarily fuel and energy, and metallurgy). However, mutual investment in medium- and high-tech industries is also being made. Not only do such investments promote the development of new sectors in smaller CIS countries (e.g., telecommunications), they also help to enhance the export structure of bigger countries (e.g., in mechanical engineering).

The territorial widening of MMI CIS's "area of responsibility" has been dictated by the multi-directional nature of most CIS investment links i.e., those of Russia (Kuznetsov, 2006), Ukraine (to an even greater extent) and others. In the light of plans to promote integration with the EU – under the aegis of the Eurasian Economic Union rather than of Russia alone – the monitoring should be extended to cover the mutual investment of EU countries and Russia, Ukraine, Belarus and Kazakhstan. And, in the longer term, bearing in mind the growing role of China, South Korea and other Asian countries, similar monitoring exercises would be informative for Russia, Kazakhstan and other Central Asian countries vis-a-vis the Asia-Pacific region. Unfortunately, to date most FDI data are based on estimates only and are given little coverage in official CIS publications; this highlights the need to redouble our efforts in building databases to support the integration of the EurAsEC countries.

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# 9

## Monitoring social moods in the post-Soviet space: EDB Integration Barometer

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In April-May 2012, the Eurasian Monitor conducted its latest study on public opinion in the post-Soviet space, devoted to the theme of people's attitude towards integration between countries. This study was conducted jointly with the Centre for Integration Studies of the Eurasian Development Bank (EDB) and with its support. The project, EDB Integration Barometer<sup>1</sup>, consisted of nationwide polls in 10 CIS countries as well as in Georgia, questioning over 13,000 people (between 950 and 2,000 in each country). The sample universe in each country represented the adult population by gender, age and type of settlement.

The post-Soviet space is an arena of close economic, technological, political and cultural interaction. Integration between countries of the former Soviet

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<sup>1</sup> The full version of the EDB Integration Barometer analytical report available at: [http://www.eabr.org/r/research/analytics/centre/projects/integration\\_barometer/](http://www.eabr.org/r/research/analytics/centre/projects/integration_barometer/)



Union results from intrinsic objective and economic factors such as geographic proximity, trade and agricultural relations, infrastructure and a common historic background. Since the collapse of the Soviet Union, cooperation on Eurasian integration has become an essential element in the formation of economic relations in the region, promoting social and economic stability, and has turned into an effective mechanism of comprehensive regional interaction.

Government bodies, business structures and the expert community therefore need accurate and methodical sociological information describing the nature of integration processes, including analysis of how citizens of the former Soviet countries relate to integration and institutions of integration. The deepening of economic integration within the framework of the Customs Union and the Single Economic Space of Russia, Kazakhstan and Belarus intensifies the need for systematic, highly-professional work of this kind.

At the same time, foreign policy activities in the post-Soviet states are interwoven with public opinion, and integration or disintegration efforts have to take account of the mass consciousness and factors affecting prevailing moods. The average person's opinion on foreign policy is therefore an essential factor in forming internal policy.

There are now many government and private research companies that carry out studies and polls of the population on a variety of topics operating in almost all countries of the former Soviet Union. However, until recently, there have been no institutes devoted to conducting regular evaluation of the foreign policy, foreign economic and other integration preferences of citizens of the region. The EDB Integration Barometer project was designed to fill this significant knowledge gap by developing the necessary methodology and conducting annual social studies on this range of issues.

A terminological problem arises in the study of integration, related to the need to differentiate between cooperation (high-level collaboration between states, directed towards the achievement of common goals) and integration (interdependent economies, common "rules of the game" for transactions, shared culture). However, it is impossible to design tools for mass polls based on the nuances of these terms: studies involving the populace require simple and unambiguous formulations. Therefore, for the convenience of the study, we have equated the terms "integration preferences" and "attraction between the countries evident in the views of the population of these countries". The "attraction" construct combines both possible cooperation and possible integration, and even a general positive disposition to people in the other country. The decision to define the subject in this way allowed us to avoid any artificial limitations imposed by terminology.

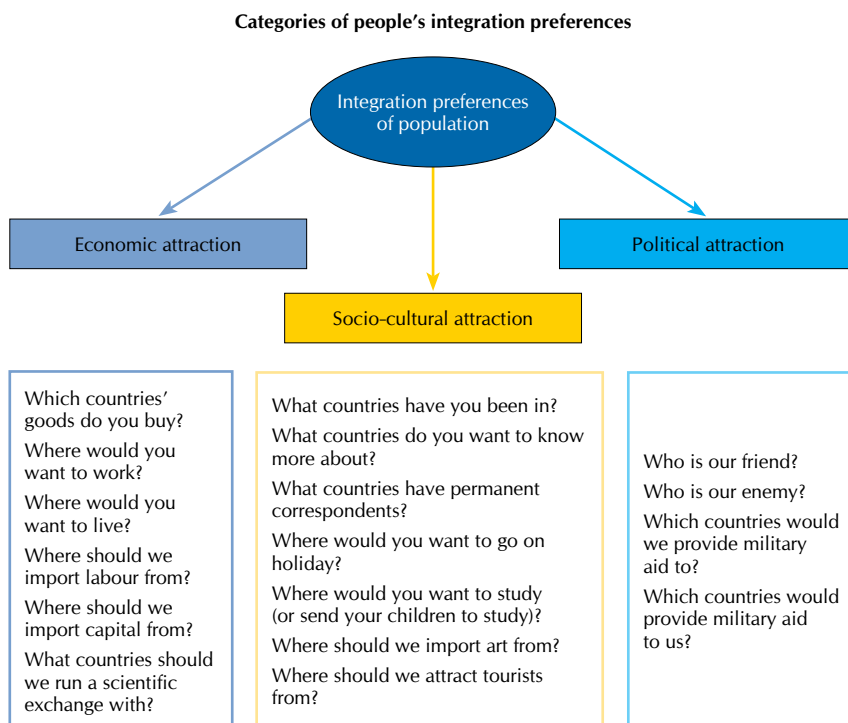
Taking into account this reason, the goal of the study may be formulated as follows: to evaluate the degree of economic and humanitarian affinity of the CIS

countries (and Georgia), expressed through the attitudes of the populations of these countries towards other countries of the former Soviet Union (except for the Baltic States) and a range of other countries round the world. Respondents' attitudes toward other countries are categorised in a range of indicators displayed in questions on a survey form.

Each question on the survey form is designed to reflect the degree of the respondent's social and cultural affinity with different countries, on the corresponding indicator. The respondent expresses both his/her personal disposition to the countries out of the prescribed list, and also the disposition desirable for his/her country.

The questions forming the main part of the survey are all of the same basic type: respondents are asked to match countries from the prescribed list with qualities such as friendly/non-friendly, familiar/unfamiliar, interesting/uninteresting, and so on. In other words, the survey form consists of dichotomous pairs.

The list of answers that respondents can choose from gives rise to three groups of conclusions for each question: a desire for integration with other post-Soviet states, a desire for integration with countries outside this region, and a desire for



The list of answers that respondents can choose

Answer options	Indicator to be calculated
Azerbaijan	Attraction to the post-Soviet space as a whole and to separate countries in it
Armenia	
Belarus	
Georgia	
Kazakhstan	
Kyrgyzstan	
Moldova	
Russia	
Tajikistan	
Turkmenistan	
Uzbekistan	
Ukraine	
Great Britain	Attraction to the European Union
Germany	
France	
Other countries of the European Union	Attraction to the rest of the world
India	
China	
USA	
Turkey	
Japan	
Countries of Arabic-Islamic World (Middle East and Northern Africa)	
Other countries	
No countries	Autonomy
Cannot say	

autonomy (evident from a high proportion of refusals to mention any countries as “attractive”). Possible choices are shown in table above.

An additional basis on which to classify conclusions about people’s integration preferences is the functional direction of this integration, the sphere in which integration could take place. Regional integration is a multilevel process, which, along with economic cooperation, includes issues of politics, security and socio-cultural interaction. We therefore divided our questions to the population into three categories: economic, political and socio-cultural. The composition of the indicators in each of these groups is illustrated in next figure (brief versions of the questions).

It is worth noting that not all the questions out of the sets were asked in each country. This is connected mainly with differences in labour rates and the volume of work involved in conducting nation-wide polls in different post-Soviet states. Using the complete version of the survey form in each country would result in an unjustified budget increase. Instead, an obligatory minimum was defined for all countries, and 9 indicators out of the initial set were measured in each of the 11 countries.

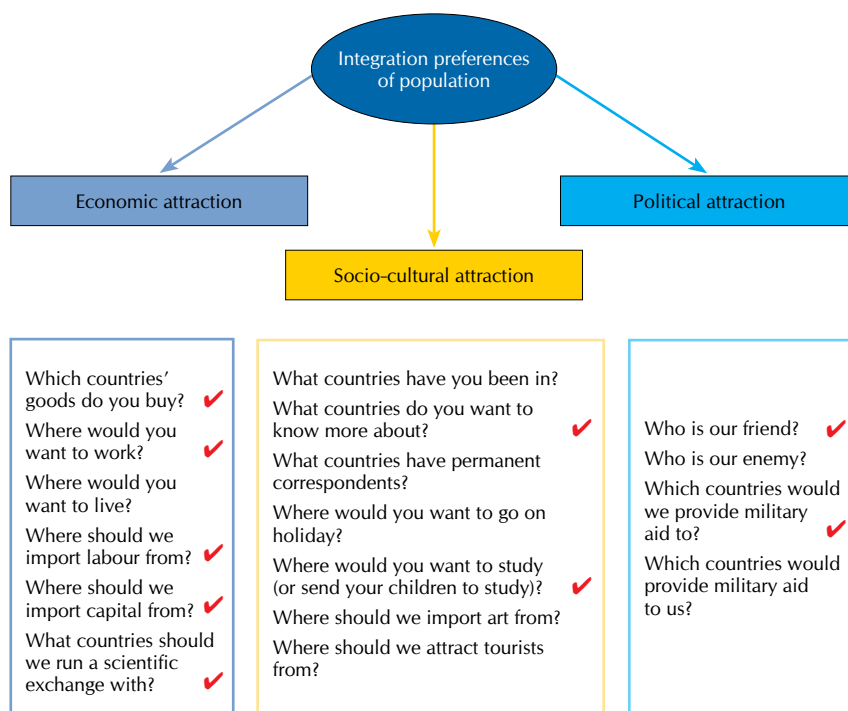
Two different approaches were used when interpreting the collected data:

- Study of individual common factors revealed in the distribution of respondents' answers to each separate question.
- Study of general tendencies revealed in composite indexes.

Now let us take a closer look at the method of calculating consolidated indexes.

When constructing the indexes, only the questions which were asked in all 11 countries were taken into account. These questions are marked by ticks in figure below.

The questions which were asked in all 11 countries (marked by ticks)



Based on the questions listed, two types of indexes were calculated:

- Indexes of attraction to a geopolitical cluster – to the former Soviet Union, European Union or other countries. These were calculated as the number of answers that mentioned at least one country of the cluster, taken as an average across all questions and expressed as a ratio to the total remaining answers (including the answer "None"). The index could range between 0 and 1 (theoretically); in fact, the actual range of the values was [0.3; 0.7].
- Indexes of mutual attraction – these are the indexes of mutual attraction between each dyad of countries, evident in reciprocal choice of answers. For example: if Ukrainians mentioned Belarus in 12% of their answers, and Belarusians mentioned Ukraine in 34% of the answers, then the proportion of reciprocal choice in this case is 12%. Thus, this indicator is cleared of the inevitable asymmetry in terms of attraction of non-equilibrium countries.

Since the base for calculating the indexes contains at least two questions from each category (economy, politics, socio-cultural links), it is possible to calculate not only general indexes from the data as a whole, but from individual data too, to determine the degree of the countries' affinity in the separate spheres of economy, politics and socio-culture. Both the individual indexes of affinity with a cluster of countries and the dyad indexes of mutual attraction were calculated for each sphere.

The basic regularities found out following the results of analysis of consolidated indexes of attraction to the geopolitical clusters are given below.

- In the political sphere, for almost all countries participating in the EDB Integration Barometer project, the highest-priority integration area is the post-Soviet space. The only exception is Georgia, which is oriented towards the US ("Other countries" cluster).
- In the economic sphere, an orientation towards the European Union is typical for six countries – Armenia, Belarus, Georgia, Moldova, Russia and Ukraine. Kazakhstan, Kyrgyzstan and Tajikistan are attracted to the post-Soviet space instead, and the "Other countries" cluster is the priority for the population of Azerbaijan and Uzbekistan.
- Almost the same patterns as for the economic sphere are typical for the sphere of socio-cultural links. The only difference is the position of Tajikistan, which in this case has the higher-priority attraction not to the post-Soviet space but to the rest of the world. However, the population of Tajikistan seems to be more oriented towards the post-Soviet space (in particular, Russia) than the population of other countries with regard to all questions on the survey form (including those not used in calculating the summarising indexes).
- For the aggregate of the three factors – economy, politics and culture – most countries participating in the project place the highest priority on integration within the post-Soviet space.

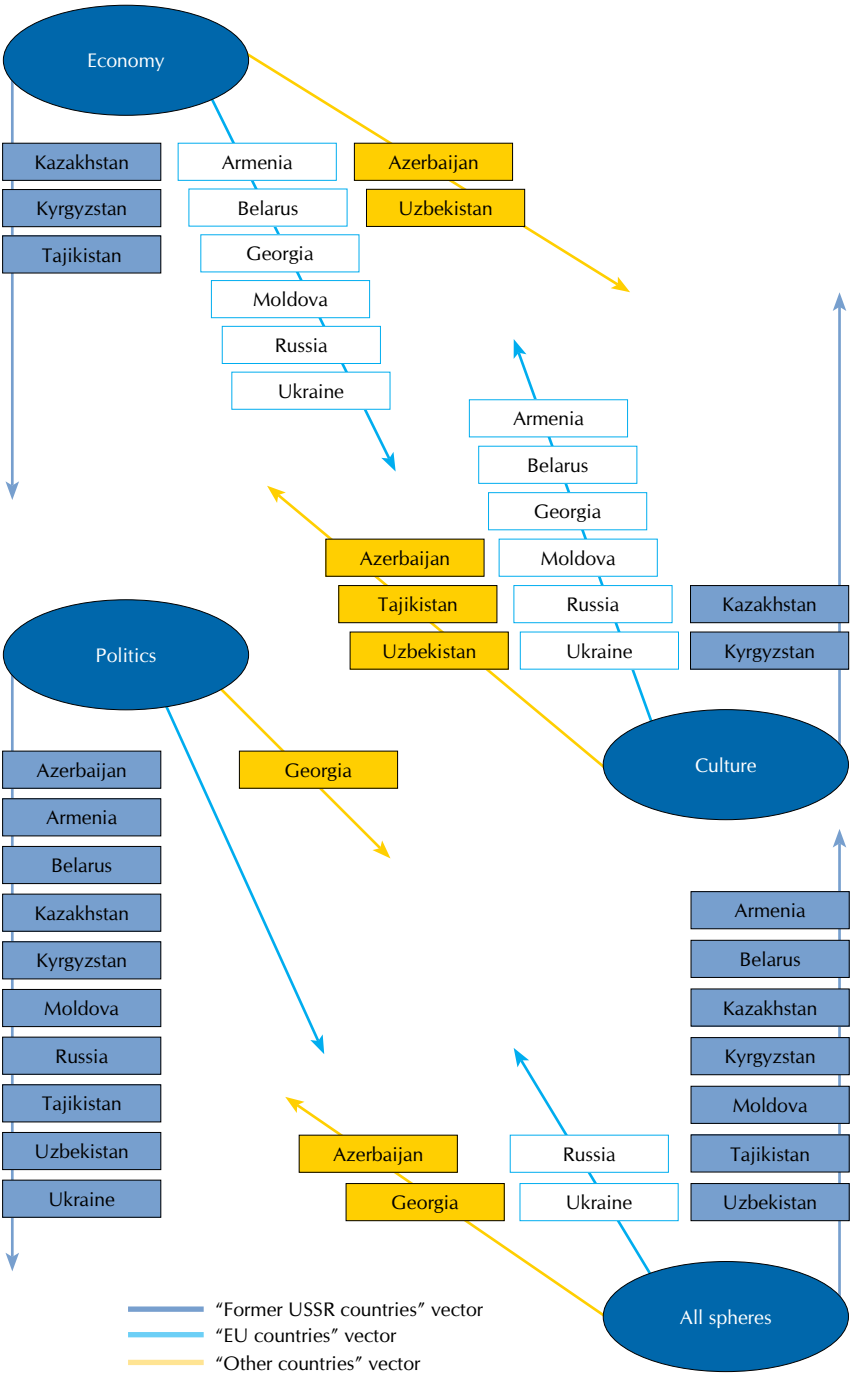
- Two countries, Azerbaijan and Georgia, feel an affinity primarily with the rest of the world, on the aggregate factors.
- Within the post-Soviet space, Ukraine and Russia are the two countries of highest interest for the citizens of other countries of the former Soviet Union. In contrast, in Ukraine and Russia the population appeared to be oriented not towards the post-Soviet space, but primarily to the European Union.

Legend:  
 % Index with the highest value of three  
 % Index with the second-highest value of three  
 % Index with the lowest value of three

The data evidencing the conclusions mentioned above are given in below (average values of indexes). An illustrative scheme of the countries' distribution on geopolitical vectors based on the table data is given in next figure 9.1.

Average values of indexes

	Azerbaijan	Armenia	Belarus	Georgia	Kazakhstan	Kyrgyzstan	Moldova	Russia	Tajikistan	Uzbekistan	Ukraine	Average
Economy												
"Former USSR countries" Cluster	0.22	0.29	0.26	0.18	0.34	0.42	0.35	0.12	0.42	0.31	0.21	0.28
"European Union Countries" Cluster	0.23	0.30	0.32	0.36	0.22	0.18	0.36	0.36	0.13	0.21	0.35	0.27
"Other countries" Cluster	0.41	0.23	0.30	0.36	0.34	0.35	0.21	0.32	0.41	0.37	0.27	0.32
Politics												
"Former USSR countries" Cluster	0.48	0.63	0.67	0.33	0.69	0.54	0.49	0.49	0.66	0.63	0.52	0.56
"European Union Countries" Cluster	0.05	0.20	0.06	0.12	0.09	0.03	0.26	0.17	0.09	0.08	0.18	0.12
"Other countries" Cluster	0.38	0.07	0.19	0.38	0.16	0.18	0.08	0.21	0.22	0.22	0.16	0.20
Culture												
"Former USSR countries" Cluster	0.19	0.25	0.25	0.11	0.35	0.36	0.32	0.09	0.37	0.20	0.17	0.24
"European Union Countries" Cluster	0.23	0.35	0.31	0.48	0.20	0.21	0.40	0.31	0.18	0.23	0.33	0.29
"Other countries" Cluster	0.38	0.15	0.20	0.33	0.28	0.34	0.18	0.22	0.39	0.35	0.18	0.27
General indexes of attraction												
"Former USSR countries" Cluster	0.27	0.36	0.35	0.20	0.42	0.43	0.37	0.20	0.46	0.36	0.27	0.34
"European Union Countries" Cluster	0.19	0.29	0.26	0.33	0.19	0.15	0.34	0.31	0.13	0.18	0.30	0.24
"Other countries" Cluster	0.39	0.18	0.25	0.36	0.28	0.31	0.18	0.27	0.36	0.33	0.23	0.29



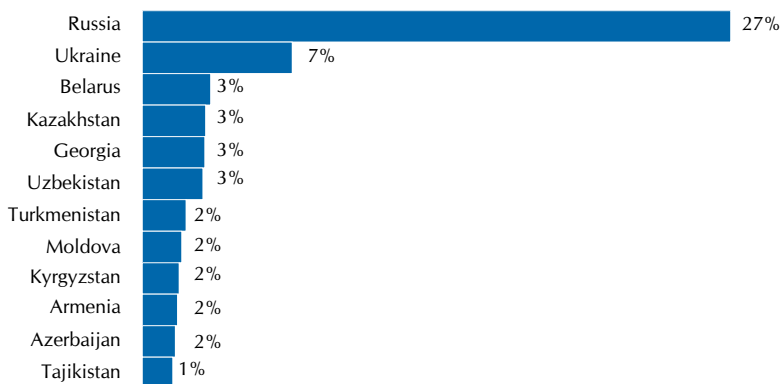
**Figure 9.1.** Illustrative scheme of the countries' distribution on geopolitical vectors

Let us return to the fact that two different approaches were used in interpretation of the collected data – study of individual common factors using the distribution of answers, and analysis of general tendencies using the consolidated indexes. We have already specified some data about general tendencies, and so now it is worth giving some details relating to individual common factors.

Almost all questions revealed an extremely low incidence of affinity with post-Soviet states other than Russia. In other words, Russia is the main attractor and other states are only of low or peripheral significance to each other. Both the practical and the cognitive interests of the population of the post-Soviet states, when they are focused within this region at all, are as a rule oriented toward Russia.

Within the post-Soviet space, Russia and Ukraine occupy the first two places in the rating of the objects of cultural, cognitive or practical interest. Correspondingly, most respondents who name no country of the post-Soviet space as being of interest for them are located in Russia or Ukraine. The imbalance is obvious: Russia and Ukraine are of the most interest to citizens of other countries, while the citizens of Russia and Ukraine are the least interested in any other post-Soviet country. This is illustrated in the following two diagrams. On average, Russia and Ukraine are mentioned more often than other countries in the post-Soviet space, yet simultaneously they give the highest percentage of answers professing no interest in other countries.

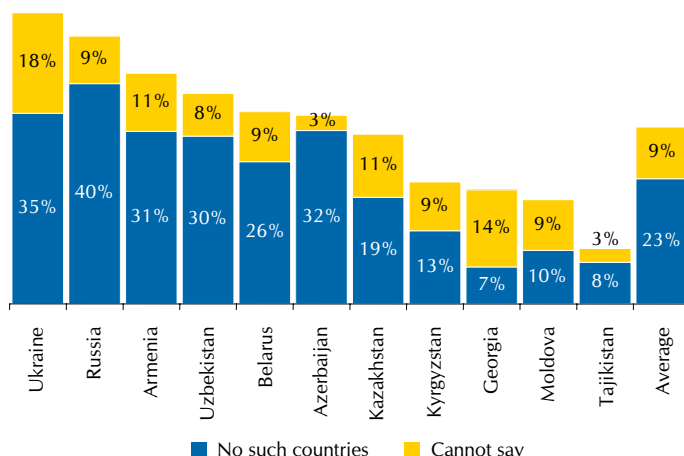
Of which countries listed below could you say that you are interested in their history, culture and geography (nature)? (Average percentages for 11 countries)



On the economic theme, the proportions of answers for each country falling to each of the three largest geopolitical clusters – “Former USSR countries”, “European Union”, “Other countries” – are on the whole very similar. This means that none of the three clusters takes priority over the others, but deviations are

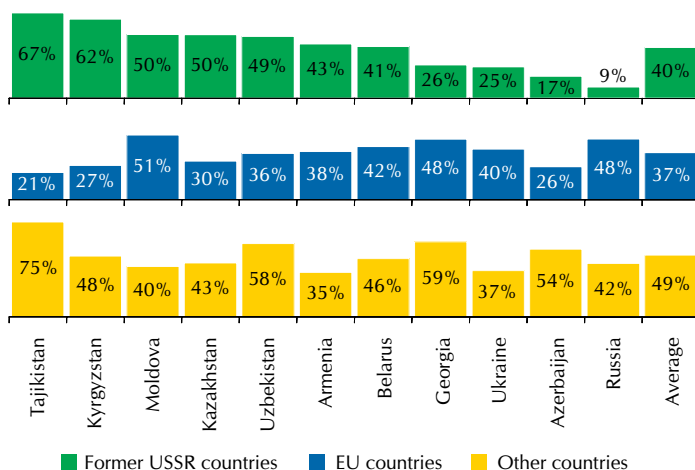


Of which countries listed below could you say that you are interested in their history, culture and geography (nature)? (Autonomy indexes)



always evident in the details. Thus, variation towards the post-Soviet space is typical for the countries of the Central Asian region and Moldova; toward the European Union for Russia, Georgia and Moldova (which is attracted to Russia and Romania simultaneously); and toward the rest of the world for Azerbaijan and Tajikistan. Turkey is a priority for Azerbaijan, and the priorities for Tajikistan vary depending on the question (China, the US and Turkey). The diagram below illustrates this data (percentage indexes should be read as follows: "At least

From which countries would an inflow of capital, investments, companies, entrepreneurs and businessmen be desirable for our country? (Answers grouped in three categories)

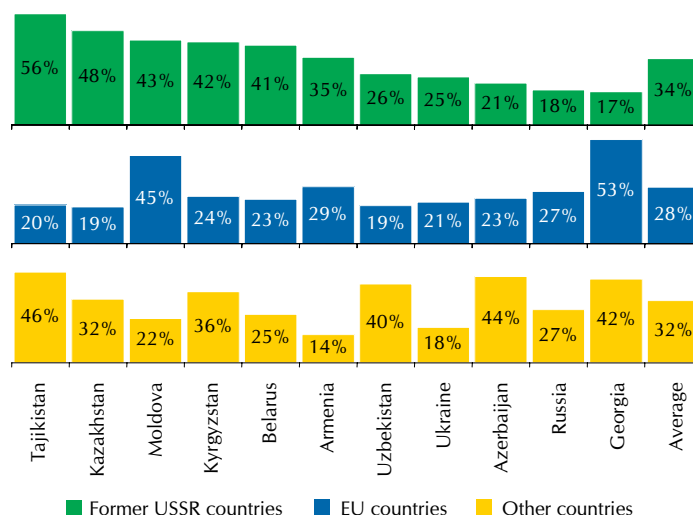


one country out of the group of countries was named". For example, 67% of respondents in Tajikistan named at least one country of the former Soviet Union).

In the political questions, the average proportions of answers by country are visibly shifted towards the post-Soviet space, both in a positive sense – for example, in the question about friendly countries – and in a negative sense, as in the question about unfriendly countries). The only country whose population is oriented towards military and political support beyond the limits of the post-Soviet space is Georgia.

The patterns of socio-cultural interest are similar to those of economic interaction: Central Asian countries are oriented towards the post-Soviet space and, to a lesser extent, towards China and Muslim countries; Moldova is oriented simultaneously towards Russia and Romania; Georgia towards the European Union and USA; Azerbaijan towards Turkey; and Russia and Ukraine have a less-than-average orientation towards the post-Soviet space, while their level of attraction to the European Union and the rest of the world corresponds to the country averages.

Of which countries listed below could you say that you are interested in their history, culture and geography (nature)? (Answers grouped in three categories)

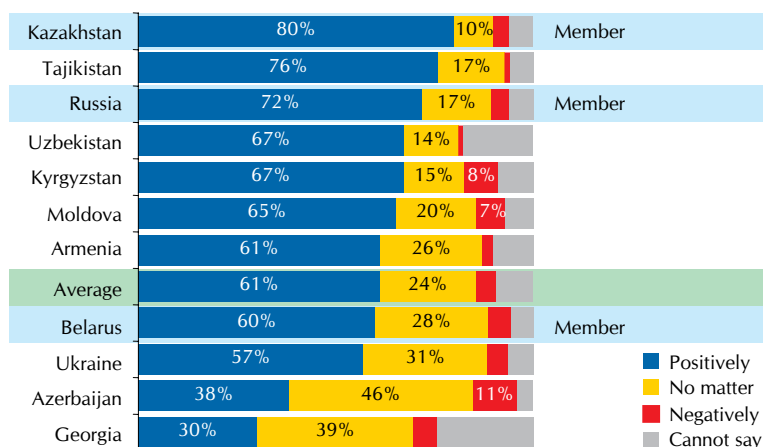


A range of additional indicators was used in the study besides the central block of dichotomous questions. The main results are given below.

Attitudes held by the post-Soviet states towards establishment of the Customs Union and the Single Economic Space appeared to be rather positive: over half

of the respondents gave positive answers. It is particularly remarkable that these integration efforts are perceived positively not only in those countries affected by incorporation. A high proportion of positive answers was characteristic for Tajikistan, Uzbekistan, Kyrgyzstan and Moldova: countries whose inhabitants are relatively more oriented towards economic cooperation with other countries of the former Soviet Union, and, most of all, with Russia.

**What do you think about Belarus, Kazakhstan and Russia uniting into the Customs Union (which abolished duties on trade between the three countries)?**



Both official integration mechanisms also receive an above-average level of support in Moldova and Armenia, which do not have common borders with the Customs Union or the Single Economic Space, and, accordingly, could not take full advantage of hypothetic incorporation. This high level of attraction is partially connected with the history of migrant labour from these countries – the intensity of this flow may be illustrated by the fact that three-quarters of Armenian citizens and every second citizen of Moldova currently have permanent communications with relatives and friends in Russia.

High support for the Customs Union appeared to be typical for two countries which are potential members of the Customs Union – Tajikistan and Kyrgyzstan.

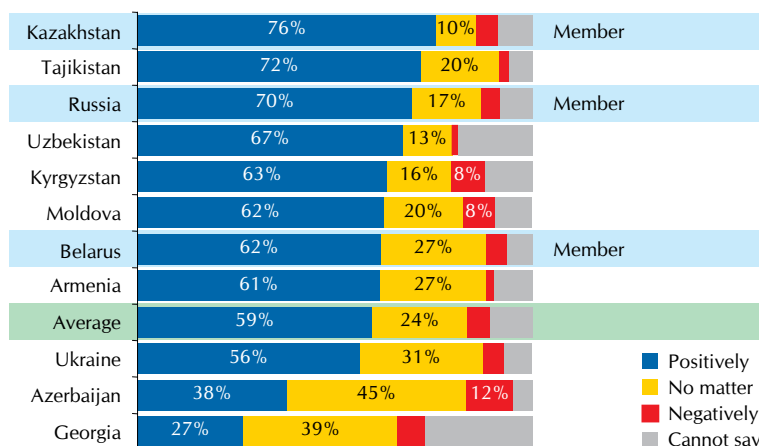
It is also interesting that the official integration mechanisms receive high support in Uzbekistan, in spite of the noticeable isolationist tendencies of the population evident from the answers to other questions.

Out of the three members of both the Customs Union and the Single Economic Space, membership is least supported in Belarus and most highly supported

in Kazakhstan, although, in all three of these countries, over half of the adult population supports these integration associations.

There are only two countries on the total list of countries where the share of positive opinions on the Customs Union and the Single Economic Space is less than half, and those two countries are Azerbaijan and Georgia. The complex relations, or rather breakdown of relations between Russia and Georgia (refer to the war of 2008) make it rather hard to anticipate positive evaluations of the integration associations with Russian participation from the population of Georgia, and the integration preferences of Azeris are directed beyond the territory of the former USSR, in particular, towards Turkey.

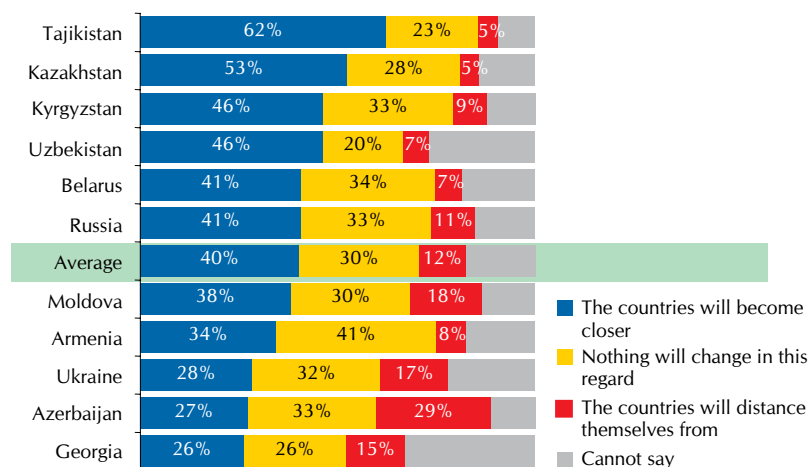
**What do you think about the fact that, in addition to the Customs Union, Belarus, Kazakhstan and Russia have created the Single Economic Space (essentially a single market composed of three countries)?**



The absolute majority of the population in each country believes that in the next five years the post-Soviet states will at least not distance themselves from each other – the percentage of responses “The countries will drift apart” does not rank first in any country. In Tajikistan and Kazakhstan, the rate of respondents who believe that in the next five years the post-Soviet states will become closer exceeds 50%.

Integration preferences depend significantly on age, and this dependence takes two forms. The first is typical for Uzbekistan, Kyrgyzstan and Azerbaijan and, to a somewhat lesser extent for Kazakhstan, where among the older age group, attraction to the “Former Soviet countries” cluster is significantly higher and attraction to the “European Union countries” and “Other countries” clusters is significantly lower throughout the entire sample.

**Do you think the countries of the former USSR will become closer or distance themselves from each other in the next five years?**



Another type of integration preferences depending on age is typical for Georgia, Armenia, Moldova, Ukraine, Belarus and Russia – the younger the age, the more often EU countries and the rest of the world are mentioned, while the percentage of references to post-Soviet states stays virtually unchanged. The key difference between the listed countries and the Central Asian countries and Azerbaijan is that their older respondents do not differ greatly in their integration preferences from the representatives of the middle and younger age category. Therefore, the older generation of the Central Asian countries is experiencing greater attraction to the post-Soviet states.

This was the first time a large-scale survey of public opinion on the issues of post-Soviet integration, covering establishment of economic and cooperation links, social and business contacts and cultural interaction, has been held in the CIS countries. The result was a detailed view of the preferences of citizens of the CIS countries with regard to a variety of aspects of integration and regional cooperation. It is assumed that the EDB Integration Barometer survey will be held annually as a monitoring survey, which will make it possible to evaluate long-term trends in public opinion in the CIS countries.

# 10

## Developing Air Transport Potential of the EurAsEC Countries

Aigul  
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The purpose of this article is to describe the current state of EurAsEC's civil aviation and analyse its prospects, paying special attention to airfreight transportation. We will discuss opportunities for further cooperation in civil aviation within EurAsEC, taking into account the establishment of the Common Transport Space, the Customs Union and the Single Economic Space. We will also examine air traffic between Asia and Europe and possible ways of maximising the potential of Eurasian transit links. The article is based on the EDB sector report No.13, Developing EurAsEC's Air Transport Potential.

### INTRODUCTION

Civil aviation is a vital component of the transport systems of EurAsEC member states, contributing to their sustainable economic growth, foreign trade, tourism, and population mobility.

EurAsEC's undisputed achievement in the area of civil aviation is the use of harmonised standards, aviation rules and procedures (in particular with respect to airworthiness, operational suitability of airports, airport equipment, air routes and air accident investigations) as a result of their common adherence to the Agreement on Civil Aviation and Use of Airspace, signed by all EurAsEC member states in 1991. However, integration processes in EurAsEC have not yet had an effect on many aspects of civil aviation, including the development of freight traffic and exploitation of transit potential.

Globally, integration in air transport and the establishment of common markets in air transport services are important processes. This practice also

shows that mutually beneficial cooperation between governments, air carriers and other suppliers of air transport services develops in a gradual fashion, in full compliance with the policies, standards and recommended practices of the International Civil Aviation Organisation (ICAO). Freight traffic is a key component of integration processes.

### THE IMPORTANCE OF DEVELOPING AIR TRANSPORT POTENTIAL

In 2010, foreign trade turnover in EurAsEC exceeded \$780 billion (4.6 times greater than in 2000). Exports grew 4 times and imports 6.2 times over the same ten-year period. Mutual trade between EurAsEC member states made up \$47 billion in 2010, accounting for approximately 10% of their total exports and 16% of imports (EDB, 2011b). Freight traffic between EurAsEC countries by all transport modes, except waterways transport and pipeline, is shown in Table 10.1.

Country	Belarus	Kazakhstan	Kyrgyzstan	Russia	Tajikistan	Total export
Belarus		0.2	0.1	6	0.1	6.4
Kazakhstan	0.7		2.4	29.4	1	33.5
Kyrgyzstan	0	0.3		0.2	0.1	0.6
Russia	7.9	6	1.4		1.4	16.7
Tajikistan	0	0.06	0.04	0.2		0.3
Total import	8.6	6.6	3.9	35.8	2.6	57.5

**Table 10.1.**  
Cargo transported  
between EurAsEC  
member states by  
road, rail and air in  
2010 (million tonnes)

Source: EDB, 2011b

In addition, 500 million tonnes of freight are transported by pipeline or rail and road transport to seaports for transit to third countries.

Third countries' net transit through EurAsEC in 2010 (by all transport modes, except waterways and pipeline) was estimated at 5 million tonnes. The main routes were between East and Southeast Asia (including China) and Europe, Central Asia (Afghanistan, Turkmenistan, Uzbekistan) and Europe, and the Black Sea countries (Ukraine, Turkey and others) and the Baltic States and Northern Europe (see Table 10.2).

**Table 10.2.**  
Forecasted cargo  
transportation in  
EurAsEC by road and  
rail for 2015-2020  
(million tonnes)

Source: EDB, 2011b

	2000	2005	2010	2015 (forecast)		2020 (forecast)	
				conservative	optimistic	conservative	optimistic
Within EurAsEC	23.4	45.9	57.6	70	90	80	120
Third countries' transit through EurAsEC	1	2	5	7	10	10	15

The share of civil aviation in total freight transportation between EurAsEC countries is insignificant (see Table 10.3). In 2010, air cargo transported between the member states stood at 15,000 tonnes, or 0.03% of the total (excluding goods transported by pipeline).

**Table 10.3.**  
Scheduled  
and non-scheduled  
cargo and mail  
traffic between  
EurAsEC member  
states (tonnes)

Source: Interstate  
Aviation Committee

Note: N/A – data not  
available

Country	Belarus	Kazakhstan	Kyrgyzstan	Russia	Tajikistan	Total export
Belarus		N/A	N/A	N/A	N/A	N/A
Kazakhstan	N/A		13	1,458	5	N/A
Kyrgyzstan	N/A	N/A		746	11	N/A
Russia	53	5,388	2,386		653	N/A
Tajikistan	N/A	79	8	1,274		N/A
Total import	N/A	N/A	N/A	N/A	N/A	N/A

At the same time, cargo transit through EurAsEC (i.e., with a transit stop in its international airports) by national and foreign airlines totalled approximately 400,000 tonnes per year.

According to the Boeing Corporation (Boeing Corporation, 2010), an additional three million tonnes of transit cargoes are transported between Asia and Europe through EurAsEC by traditional passenger airlines (in baggage holds of passenger aircraft), cargo carriers and airmail companies.

Air transportation accounts for approximately 3% of tonnage and up to 15% of the value of all cargo traffic between Europe and Asia. For the past 20 years, these figures have been growing and increases in air cargo traffic have been significantly higher than increases in passenger traffic. The undisputable advantages of transporting freight by air between Europe and Asia are its speed (several hours), point-to-point delivery and high quality (accuracy and safety). Significant efforts are being made to shorten on-ground processing, which often accounts for around 90% of delivery time.

As well as being affected by general economic factors, the air freight transportation market is influenced by the widespread use of safe and fuel-efficient aircraft, as well as changes in international trade patterns (in particular, an increase in the proportion of highly processed products).

Attracting Europe-Asia transit flows to EurAsEC air routes is important for three main reasons:

1. Levying additional air navigation charges for transit flights will help improve air traffic services (ATS) and air traffic management (ATM) infrastructure in EurAsEC member states;



2. Increasing the number of technical stops at EurAsEC airports will foster the improvement of aerodrome and airport infrastructure, create new jobs and have a multiplier effect on other sectors e.g., fuel supplies and maintenance; and
3. Increasing the number of commercial stops will help advance logistics in Eurasia, improve delivery speed and enhance exporters' access to the largest global markets. The development of air cargo traffic between Europe and Asia with commercial stops in EurAsEC airports will have a significant multiplier effect on transport systems and other sectors.

In the context of globalisation, civil aviation plays an increasingly important role and assures expanding EurAsEC member states' access to global markets. Air transport is particularly important to the resolution of socioeconomic problems and the improvement in people's quality of life, especially in regions without ground transportation systems.

In recent decades, civil aviation's role in the global economy has been increasing steadily. A total of 2.5 billion passengers (approximately 40% of the world's population) and 46 million tonnes of freight and mail are transported by air every year. Commercial flights are serviced by 25,000 aircraft, with a maximum takeoff weight (MTOW) of more than 9,000 tonnes. There are approximately 40,000 civil airports on the globe, including 1,000 international airports.

The aviation industry accounts for approximately 8% (about \$3 trillion) of the global gross domestic product (GDP). It also has multiplier effect on other sectors such as tourism, oil processing, maintenance and construction.

Over the past 20 years, international cargo traffic has increased 2.5 times to 167 billion revenue tonne kilometres (RTK), 90% of which is provided by scheduled airlines (Boeing Corporation, 2010). According to Boeing forecasts, this figure will triple by 2029, averaging 5.9% annual growth.

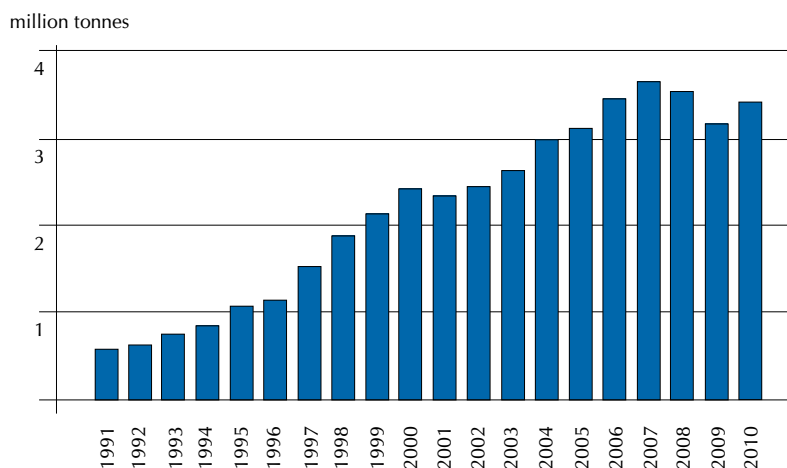
Despite the 1997 and 2001 economic recessions and the 2008-2009 global economic crisis, cargo air traffic between Europe and Asia averaged 9.8% growth a year, totalling 3.2 million tonnes in 2009. In 2010, Europe-Asia traffic was estimated at 3.7 million tonnes (see Figure 10.1).

Europe-Asia flows now account for 19.3% of the world's cargo traffic by commercial civil aviation and 9.2% of transported tonnage.

The Europe-Asia market is deemed to be one of the most attractive sectors for the air transportation business. It is also interesting to see how air cargo traffic is structured. The main items transported from Asia westbound are automobile parts and accessories (26.3% of the total) and from Europe eastbound are machinery and equipment (35.5%). The percentage of express mail is also high. Documents and express small packages account for 15% of Asia-to-Europe cargo flows and 9% of Europe-to-Asia traffic (Boeing Corporation, 2010).

**Figure 10.1.**  
Europe-Asia air  
cargo traffic in  
1991-2010  
(million tonnes)

Source: The Boeing  
Corporation, 2010



Boeing estimates that, over the next twenty years, Europe-Asia traffic will average 6.6% growth a year, reaching 11-12 million tonnes per year by 2029 (Boeing Corporation, 2010).

The optimal correlation of three factors (price, quality and delivery time) enables air transport to attract a significant amount of freight traffic from maritime transport, the main transportation mode for cargo moving between Europe and Asia.

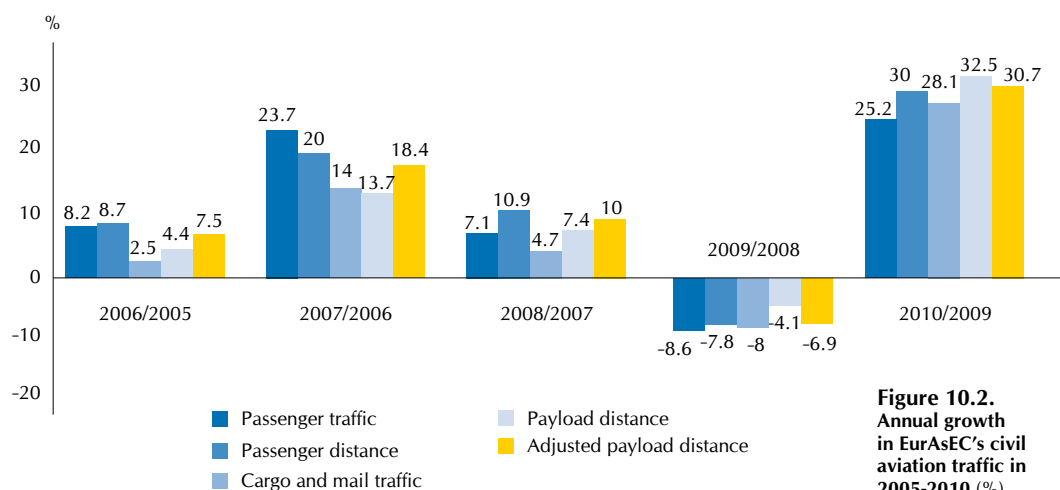
#### AIR TRANSPORT MARKET: CURRENT STATUS AND FUTURE TRENDS

During the first ten years of the 21<sup>st</sup> century, passenger and cargo traffic in EurAsEC grew steadily, underpinned by growth in real incomes and increased demand for air cargo transportation both within the Community and between the leading global markets (Europe and Asia).

Despite the decline in air traffic in 2008-2009 as a result of the global economic crisis, since 2010 all EurAsEC member states have been regaining their former positions in the air cargo market.

The development of EurAsEC's civil aviation strongly depends on general trends in world aviation and on global socioeconomic, political and other factors. In 2010, world passenger traffic on ICAO member states' scheduled airlines exceeded 4.5 trillion pkm, up 7.3% on 2009, and adjusted payload distance totalled 523.3 billion tkm (up 3.8%). This traffic grew even more rapidly in EurAsEC in 2010.

In 2010, EurAsEC's civil aviation accounted for 3.6% of the world's tonne kilometres; over the last five years its share of this market has grown by over 150% (see Table 10.4).



**Figure 10.2.**  
Annual growth  
in EurAsEC's civil  
aviation traffic in  
2005-2010 (%)

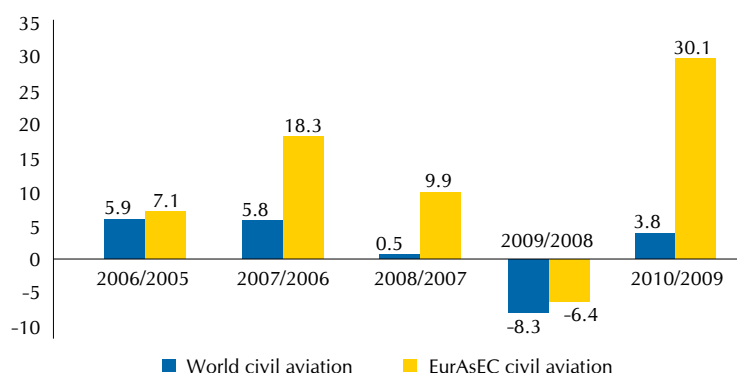
Source: International  
Aviation Committee

	2005	2006	2007	2008	2009	2010	2010/2005 (%)
ICAO member states	487.9	516.7	546.7	549.7	504.1	523.3	107.3
EurAsEC member states	11.2	12	14.2	15.6	14.6	19	169.6
EurAsEC's share (%)	2.3	2.3	2.6	2.8	2.9	3.6	+ 1.5%

**Table 10.4.**  
EurAsEC and ICAO's  
adjusted payload  
distance  
in 2005-2010  
(billion adjusted tkm)

Source: ICAO,  
International Aviation  
Committee

Over the last five years, EurAsEC's adjusted payload, passenger and payload distances have grown at a faster pace than total world civil aviation as represented by the 189 ICAO member states (see Figure 10.3).



**Figure 10.3.**  
Annual growth of  
adjusted payload  
distance in world  
and EurAsEC civil  
aviation in  
2005-2010 (%)

Source: ICAO,  
International Aviation  
Committee

Economic development and population mobility in EurAsEC member states facilitated growth of almost 280% in scheduled and non-scheduled passenger traffic in 2000-2010, from 56.9 billion pkm in 2000 to 157.7 billion pkm in 2010 (see Table 10.5).

**Table 10.5.**  
EurAsEC's domestic  
and international  
passenger traffic  
in 2000-2010  
(billion pkm)

Source: International  
Aviation Committee

	2000	2005	2006	2007	2008	2009	2010	2010/2000 (%)
Belarus	0.5	0.7	0.8	1	1.3	1.3	1.6	320
Kazakhstan	1.6	3	3.1	4.9	5.5	5.4	6.3	393.8
Kyrgyzstan	0.5	0.4	0.4	0.5	0.6	0.5	0.7	140
Russia	54	85.8	93.7	111	122.6	112.5	147.1	272.4
Tajikistan	0.3	1.0	0.8	1.2	1.5	1.6	2	666.7
Total EurAsEC	56.9	90.9	98.8	118.6	131.5	121.3	157.7	277.2

The most significant increases in passenger distance between 2000 and 2010 have been registered in Tajikistan (6.7 times), Kazakhstan (4 times) and Belarus (3.2 times).

Passenger numbers have shown a similar trend. According to the Interstate Aviation Committee, EurAsEC's passenger traffic grew 2.5 times to 62.4 million people in 2010 (see Table 10.6). The highest increases in 2000-2010 were in Kazakhstan (4.1 times), Tajikistan (4 times), and Belarus (3.3 times).

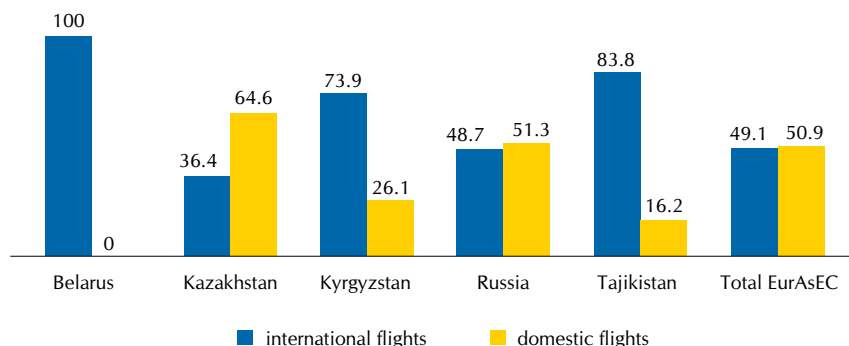
**Table 10.6.**  
EurAsEC's domestic  
and international  
passenger turnover  
in 2000-2010  
(million people)

Source: International  
Aviation Committee

	2000	2005	2006	2007	2008	2009	2010	2010/2000 (%)
Belarus	0.3	0.5	0.5	0.6	0.8	0.8	1	333.3
Kazakhstan	0.8	1.6	1.9	2.7	2.8	2.7	3.3	412.5
Kyrgyzstan	0.3	0.2	0.2	0.3	0.3	0.3	0.3	100
Russia	23	35.1	38	46.6	49.8	45.1	57	247.8
Tajikistan	0.2	0.5	0.4	0.6	0.7	0.7	0.8	400
Total EurAsEC	24.9	37.9	41	51	54.4	49.6	62.4	253.7

Russian airlines account for over 90% of total passenger, cargo and mail traffic. Kazakhstan is the second largest passenger transportation market in EurAsEC (5.3% of the total in 2010).

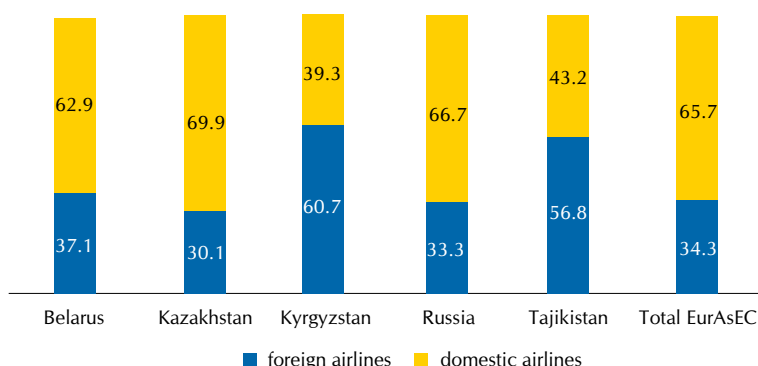
In 2010, 49% of passengers within EurAsEC travelled on international flights. In the last ten years, international passenger traffic has grown faster than traffic on domestic flights. Belarus has almost no domestic flights (see Figure 10.4). The share of international flights in Kyrgyzstan and Tajikistan is high (74% and 84%, respectively).



**Figure 10.4.**  
EurAsEC's  
international and  
domestic passenger  
traffic in 2010 (%)

Source: International  
Aviation Committee

Although leading foreign airlines provide international flights in EurAsEC and aim to expand their destination network as well as passenger and cargo traffic, domestic airlines account for approximately 66% of international passenger traffic (see Figure 10.5).



**Figure 10.5.**  
International  
passenger traffic  
through EurAsEC by  
domestic and foreign  
airlines in 2010 (%)

Source: International  
Aviation Committee

In 2010, 23.3 million passengers departed from EurAsEC airports to international destinations, of which 7.97 million people travelled by foreign airlines and 15.3 million people by domestic airlines. However, the country-to-country distribution of foreign companies' shares in international passenger traffic varies significantly. Their share is high in Kyrgyzstan and Tajikistan and relatively low in Kazakhstan and Russia.

In 2010, EurAsEC's civil aviation companies transported over 964,000 tonnes of freight and mail, a 69% increase over the last ten years. Belarus showed the highest approximately fourfold increase in freight traffic. At the same time, cargo traffic in Kyrgyzstan declined almost threefold in 2010, compared to 2000. Russia accounts for more than 96% of all cargo traffic (see Table 10.7).

**Table 10.7.**  
EurAsEC's domestic  
and international  
cargo and mail  
turnover in  
2000-2010  
(thousands tonnes)

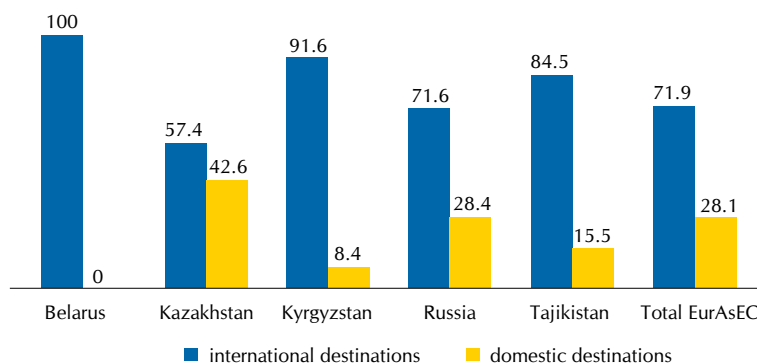
Source: International  
Aviation Committee

	2000	2005	2006	2007	2008	2009	2010	2010/2000 (%)
Belarus	4.4	14.5	25.7	20.8	17.8	22	17.48	397.3
Kazakhstan	13.8	20.7	16.5	25.7	17.6	15.8	17.2	124.6
Kyrgyzstan	2.9	1.4	0.7	0.6	0.9	0.8	1	34.5
Russia	546.6	628.9	640.3	732.2	779.4	712.2	926.4	169.5
Tajikistan	2	3.7	2.4	2.1	2.5	2.2	2.2	110
Total EurAsEC	569.7	669.2	685.6	781.4	818.2	753.0	964.3	169.3

International freight and mail traffic in EurAsEC in 2010 totalled 693,000 tonnes (71.9% of the total) and domestic traffic 271,000 tonnes (28.1%). In Belarus, cargo and mail are transported by air to international destinations only (see Figure 10.6). Russia and Kazakhstan boasted the highest domestic traffic (28.4% and 42.6% of the total, respectively).

**Figure 10.6.**  
EurAsEC's  
international and  
domestic cargo and  
mail traffic in 2010  
(%)

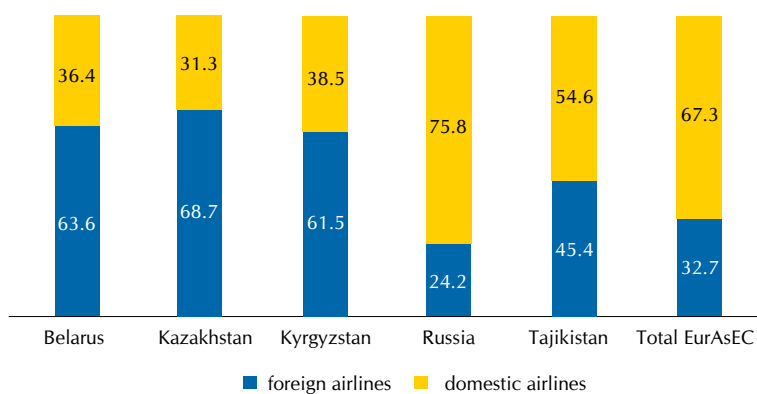
Source: International  
Aviation Committee



In 2010, foreign carriers accounted for 32.7% of cargo and mail traffic through EurAsEC's international airports. Russia is the only country where foreign airlines transport less than 25% of all freight. In other EurAsEC member states, their share is significantly higher: 63.3% in Belarus, 68.7% in Kazakhstan, 61.5% in Kyrgyzstan and 45.4% in Tajikistan (see Figure 10.7).

In terms of payload distance, EurAsEC's cargo traffic increased by 76.1%, compared to 2000. Belarus demonstrated the most significant increase (3.3 times), while in Kazakhstan and Kyrgyzstan this figure declined (Table 10.8).

As shown in Figure 10.8, in 2010 the utilisation of aircraft capacity in EurAsEC countries was significantly lower than the world average seat occupancy of 77%.



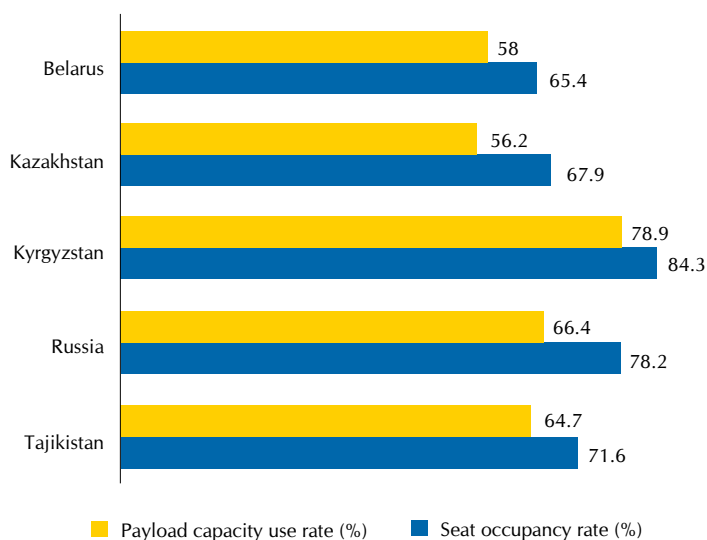
**Figure 10.7.**  
International cargo  
and mail traffic via  
EurAsEC airports by  
domestic and foreign  
airlines in 2010 (%)

Source: International  
Aviation Committee

	2000	2005	2006	2007	2008	2009	2010	2010/2000 (%)
Belarus	18	58.8	91.5	66.3	53.8	48	59.4	330
Kazakhstan	117.5	81	77.9	42.3	46.5	30	56.3	47.9
Kyrgyzstan	8.8	4.5	1.4	1.3	2.5	1.8	3.4	38.6
Russia	2600	2830.3	2932.2	3424.3	3691.6	3557.7	4715.4	181.4
Tajikistan	4.3	7.6	9.4	4.8	5.2	5.1	5.4	125.6
Total EurAsEC	2748.6	2982.2	3112.4	3539	3799.6	3642.6	4839.9	176.1

**Table 10.8.**  
EurAsEC's domestic  
and international  
cargo and mail  
traffic in 2000-2010  
(million tkm)

Source: International  
Aviation Committee



**Figure 10.8.**  
Utilisation of  
EurAsEC's aircraft  
capacity in 2010

Source: International  
Aviation Committee

The utilisation of aircraft capacity varies significantly across EurAsEC. Kyrgyzstan and Russia have the highest rates (84.3% for passenger traffic and 78.9% for cargo traffic in Kyrgyzstan; and 78.2% and 66.4% in Russia, respectively).

International commercial flights in EurAsEC are operated by more than 200 domestic air carriers and 100 foreign companies. *Table 10.9* shows the performance of the main domestic players in terms of passenger and cargo traffic.

Airline	2005	2006	2007	2008	2009	2010 (estimate)
<b>Belarus</b>						
Belavia	660	N/A	952	1,252	1,262	N/A
<b>Kazakhstan</b>						
Air Astana	2,511	2,417	4,452	4,795	4,525	5,082
SCAT	157	258	N/A	N/A	N/A	N/A
<b>Kyrgyzstan</b>						
Kyrgyzstan	183	N/A	N/A	N/A	N/A	N/A
<b>Russia</b>						
Aeroflot	20,751	22,407	24,675	27,248	25,986	34,777
Transaero	5285	7793	11,759	17,549	18,733	26,294
Sibiria/S7	10,942	12,498	13,900	14,351	13,155	10,279
Utair	2,977	3,666	4,510	5,063	5,828	7,982
OrenAir		988	1,656	3,031	4,940	7,159
Rossia (GTK Rossia)/Pulkovo	5,717	6,118	6,792	7,454	6,150	6,242
Nord Wind	N/A	N/A	N/A	71	2,898	5,086
Ural Airliny	2,348	2,609	2,998	3,948	4,035	4,841
Vladivostok Avia	1,852	2,105	2,447	2,943	3,875	4,756
VIM-Avia		3,650	5,294	4,455	3,214	3,978
Moskva Airlines/AtlantSoyuz		3,109	4,355	3,653	2,612	3,303
Yakutia	N/A	N/A	1,135	1,600	2,244	3,028
Globus	N/A	N/A	N/A	1,518	2,696	2,714
Red Wings	N/A	N/A	N/A	1,094	2,021	2,437
DonAvia (Aeroflot-Don)	911	875	1,665	2,540	2,392	2,423
NordAvia (Aeroflot-Nord)	886	1,044	1,539	1,375	1,528	1,972
<b>Tajikistan</b>						
Tajikistan	1,030	N/A	N/A	N/A	N/A	N/A
Somon Air	N/A	N/A	N/A	N/A	729	N/A

**Table 10.9.**  
Scheduled passenger  
traffic by EurAsEC's  
largest airlines in  
2005-2010  
(million pkm)

Source: ATW (2010)

Note: N/A – data not  
available



EurAsEC's largest cargo carrier is AirBridgeCargo, a member of the Volga-Dnepr Group. The company uses Boeing 747F aircraft on Europe-Asia and other routes (see Table 10.10). Polet is another emerging air carrier. This company became the first operator of the IL-96-400 freighter. Five airlines, AirBridgeCargo, Aeroflot, Volga-Dnepr, Polet and Transaero, account for about 84% of all cargo traffic in EurAsEC.

Airline	2005	2006	2007	2008	2009	2010 (estimate)
<b>Belarus</b>						
Belavia	1,181		1,810	2,000	2,000	N/A
<b>Kazakhstan</b>						
Air Astana	15,857	20,420	38,000	48,000	38,000	N/A
<b>Kyrgyzstan</b>						
Kyrgyzstan	2,707	N/A	N/A	N/A	N/A	N/A
<b>Russia</b>						
AirBridgeCargo	N/A	N/A	N/A	1,101,798	1,317,708	2,057,883
Aeroflot	866,800	885,000	457,000	390,996	399,867	952,172
Aeroflot Cargo	N/A	N/A	N/A	436,650	426,000	-
Volga-Dnepr	748,369	995,000	661,779	618,826	526,108	499,292
Polet	N/A	N/A	179,138	161,660	105,895	246,402
Transaero	73,338	78,000	93,048	130,032	170,803	234,421
Aviacon Citotrans	N/A	N/A	N/A	55,459	61,336	101,400
Siberia/S7	67,107	82,000	92,310	120,168	98,523	91,413
Vladivostok Avia	28,765	33,000	25,830	32,496	40,907	70,479
Aerostars	N/A	N/A	20,617	25,300	25,954	36,302
Utair	14,401	17,000	21,450	23,206	23,071	31,969
Ural Airlines	14,969	14,000	13,800	15,000	20,112	32,748
Alrosa	N/A	N/A	56,783	56,247	34,912	30,100
<b>Tajikistan</b>						
Tajikistan	7031	N/A	N/A	N/A	N/A	N/A
Somon Air	N/A	N/A	N/A	N/A	1,830	N/A

**Table 10.10.**  
Scheduled cargo  
traffic by EurAsEC's  
largest airlines in  
2005-2010  
(million tkm)

Source: ATW (2010)

Note: N/A – data not  
available

The specific features of EurAsEC's air cargo market are that its domestic carriers are market leaders in non-scheduled flights by ramp aircraft and that foreign companies are now expanding their presence in the express cargo and mail delivery markets.

The express delivery market in EurAsEC is dominated by the "Big Four" (DHL, TNT Express, United Parcel Service and Federal Express) and accounts for more

than 50% of all mail transported by air. The market leader is DHL. Experts estimate that 60%–75% of express mail is flown to international destinations.

The ramp aviation<sup>1</sup> segment handles transportation of outsize and heavy cargoes, machinery or other freights that cannot be transported in standard air-freight containers for whatever reason. The leaders in this segment are Volga-Dnepr and Polet, whose fleets include ramp aircraft such as the IL-76 and the AN-124 Ruslan.

As at the beginning of 2011, EurAsEC had 99 functioning international airports, 49 of which (49.5%) were assigned ICAO categories (see Table 10.11).

**Table 10.11.**  
EurAsEC's  
international  
airports, including  
ICAO category  
aerodromes

Source: CIS (2007)

Note: \*Airports with  
runways having  
ICAO categories

Country	Total international airports	Categorised aerodromes *			
		Total	Category		
			I	II	IIIA
Belarus	7	1	-	1	-
Kazakhstan	16	7	4	1	2
Kyrgyzstan	2	1	1	-	-
Russia	72	39	26	10	3
Tajikistan	2	1	1	-	-
Total EurAsEC	99	49	32	12	5

Less than one third of EurAsEC's international airports are suitable for long-range cargo aircraft with heavy takeoff weights such as the McDonnell-Douglas MD-11 and the Boeing-747 (various versions). The technical characteristics, including lighting and radio facilities, of Almaty, Astana, Domodedovo (Moscow), Yemelyanovo (Krasnoyarsk), Kazan, Koltsovo (Yekaterinburg), Knevichi (Vladivostok), Tolmachevo (Novosibirsk), Sheremetyevo (Moscow) and Novy (Khabarovsk) airports make it possible for them to become Europe-Asia cargo hubs. The majority of these airports have undergone extensive upgrading and construction work in 2005–2011.

As mentioned above, EurAsEC's airlines compete very successfully with foreign air carriers. However, foreign companies continue to expand their operations in the region. The largest foreign airline handling EurAsEC's international cargo is Lufthansa. Lufthansa Cargo carries 1.8 million tonnes of freight a year, up to 25% of which is transported from Germany to Asia Pacific destinations.

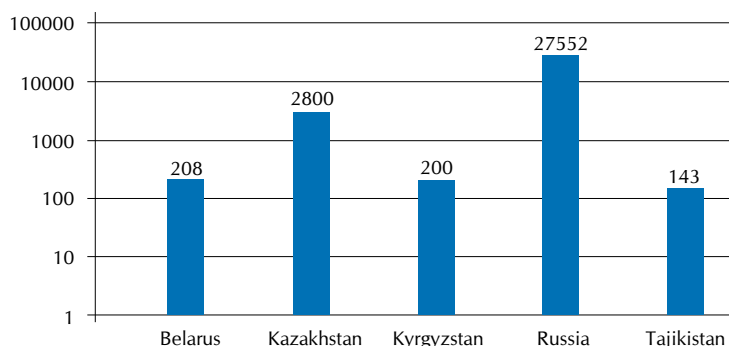
<sup>1</sup> Ramp aviation is an airlift system using ramp aircraft. A ramp aircraft has a special front or rear ramp so that the transported or loading machines can drive on board. Ramp aircrafts are widely used in military aviation and are irreplaceable in civil aviation where outsize and heavy items need to be transported.

Lufthansa's main transit hub in EurAsEC is Domodedovo. Its aircraft also make transit stops at Yemelyanovo.

Over the last few years, cargo transited through Sheremetyevo by Chinese air carriers Air China, China Southern Airlines and China Eastern Airlines, and through Domodedovo by Hong Kong's Cathay Pacific, has been on the rise. Air China Cargo also uses Tolmachevo as a transit airport. Over 30 foreign companies are executing cargo deliveries between Europe and Asia Pacific via EurAsEC and their number continues to grow.

The promising areas for the development of international traffic across Eurasia include transit by new types of aircraft such as the Airbus-380 and, in the longer term, the Boeing-747-800. However, EurAsEC's airports must undergo further reconstruction so that they can handle such types of aircraft and serve as transit or backup aerodromes.

EurAsEC's ATM bodies service a total airspace of 30.9 million km<sup>2</sup> (see Figure 10.9). All its member states belong to the Eastern Part of the ICAO European Region and, as members of the ICAO, they must endeavour to implement its national ATM harmonisation strategy.



**Figure 10.9.**  
Airspace serviced  
by EurAsEC's ATM  
bodies (thousands  
km<sup>2</sup>)

Source: International  
Aviation Committee

EurAsEC airspace includes international and domestic routes. International routes allow transit through EurAsEC, linking Europe with Asia and Asia with North America.

The six air routes that pass through EurAsEC, and which are potential transit routes for foreign air carriers, are:

- Asian routes (Northern Europe-Near East/Central Asia);
- Trans-Siberian routes (Europe-Southeast Asia);
- Transpolar routes (Europe-Japan/Korea);
- Trans-Asian routes (Europe-Southeast Asia/India/Pakistan);

- Trans-eastern routes (US/Canada-Southeast Asia); and
- Cross-polar routes (US/Canada-Southeast Asia).

Only two of the six groups cross two or more EurAsEC member states. These are the Trans-Siberian route through Russia and Belarus and the Trans-Asian route through Russia, Kazakhstan, and Central Asian countries. The other routes cross Russia only.

The main advantages of international air routes crossing EurAsEC are as follows:

- significant time savings for foreign air carriers;
- reduced transportation costs and, consequently, tariffs, which in turn generate higher demand for the Europe-Asia flights by foreign air carriers;
- increased frequency of transit flights provides additional benefits to EurAsEC member states such as ATS income and investment in airport infrastructure and ATS and ATM systems; and
- the development of international routes provides air carriers in the member states with access to Asian, European and American markets (in both passenger and cargo transportation).

EurAsEC member states' policy to expand their trade and economic cooperation and to remove obstacles to mutual trade has provided solid foundations to expand air cargo traffic, including transit. However, the region's existing potential and the opportunities it offers for international transit through its territory are not fully exploited.

The World Trade Organisation forecasts that Asia Pacific will remain the main generator of trade flows and that the amount of cargo traffic to Europe will grow dynamically. In these conditions, the countries that benefit most are those able to persuade operators to use their transport systems, including air routes, for Eurasian cargo operations.

### **OBSTACLES TO THE DEVELOPMENT OF CARGO TRAFFIC**

EurAsEC member states have similar histories and therefore face similar obstacles to the development of civil aviation. The problems that prevent, to a lesser or greater extent, the full utilisation of the Community's cargo transit potential can be grouped as follows:

1. Significant depreciation of capital assets (aerodrome and airport infrastructure, aircraft);
2. Underdeveloped logistics in the countries that could integrate cargo traffic;

3. Lack of cargo carriers in EurAsEC that could compete in the Eurasian cargo transportation sector. Over the last 20 years, this sector has fallen behind technologically and fuel costs have been proportionally higher than in other countries;
4. The need to harmonise ATM systems; and
5. Regulatory and legal issues (mainly affecting access to market and commercial rights), which can become an obstacle to the development of EurAsEC's air transport potential.

The main problem is that ground-based technology is not sufficient to meet current and future demand for cargo flights. Only a few airports and aerodromes are able to function as modern and competitive air hubs. The majority of airports face the following key problems (CIS, 2007):

- long operating life of existing airports, averaging about 50 years;
- lack of technology;
- mismatch of ground-based services with current and future volume of operations and with new types of aircraft;
- poor passenger and cargo processing services (less regular flights, lower levels of comfort and other indicators); and
- lack of aerodromes with ICAO classification for weather minimums<sup>2</sup>.

In order to integrate with the international cargo transportation system and develop their transit capacities, EurAsEC member states need to ensure greater flight regularity irrespective of weather conditions. Only aerodromes and equipment meeting the requirements of ICAO CAT I, II or III can offer all-weather operation. Currently, less than half of EurAsEC aerodromes have ICAO categories and only five aerodromes have CAT III A. There are no aerodromes in EurAsEC with CAT III B.

EurAsEC aerodromes are currently facing the following issues:

- they lack precision approach-and-landing and visual instruments, which would allow them to operate in poor weather conditions;
- the majority of runways need overhauling or rebuilding;
- lighting and power equipment is ageing or obsolete;
- the majority of radio navigation aids are ageing or obsolete;

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<sup>2</sup> Weather minimum is the minimum cloud ceiling allowing takeoff, landing and flying. Weather minimums are filed separately for an aerodrome, aircraft and pilots. At an aerodrome, weather minimums are filed separately for different runways and landing schemes.

- safety measures need to be improved, particularly with regard to the following:
  - geometric dimensions of aerodrome components and daytime marking;
  - light signalling equipment and power supply;
  - strength of pavement;
  - emergency and rescue equipment;
  - radio facilities;
  - meteorological equipment (CIS, 2007).

The development of new jumbo jets including the Airbus 380 and the Boeing-747-800 require strengthened airport pavements. There are an insufficient number of EurAsEC aerodromes that can receive such planes or serve as backup aerodromes for their transit flights. The underdeveloped logistics network undermines the competitiveness of EurAsEC airports in terms of cargo deliveries, because the time saved by air transportation is outweighed by the time of ground delivery between the airport and the freight owner. At present, only Moscow's Sheremetyevo and Domodedovo airports are integrated, to a greater or lesser extent, with Eurasian logistics chains. The development of logistics centres at airports would attract additional trade flows between EurAsEC member states and foreign countries.

Currently, AirBridgeCargo is the only Russian registered company offering scheduled commercial cargo transportation between Europe and Asia, which can stand comparison in terms of quality and quantity of services with other world leaders in the airfreight sector. AirBridgeCargo's fleet comprises and continues to be expanded with various versions of the Boeing-747 freight aircrafts. Its parent company, Volga Dnepr, and some other carriers, operate non-scheduled flights with ramp aircraft such as the AN-124.

EurAsEC's scheduled airfreight market has to be classified as undeveloped, or emerging, given the scale of operations in other regions. In 2010, for example, Cathay Pacific, one of Hong Kong's carriers, transported twice as many cargoes as all EurAsEC's air companies put together (ATW, 2010; Airline Business, 2010). The competitiveness of EurAsEC cargo carriers is undermined by the lack of modern, cost-efficient cargo aircraft such as the IL-96-400 or Boeing-747 MD-11, that meet international standards for ground noise, engine emissions and navigation precision. In EurAsEC in particular, there is a lack of aerodromes that can service such planes, which also hampers the development of cargo traffic. This continues to make air transportation in EurAsEC unattractive for potential shippers, and hence the vicious circle ensues where the lack of competition undermines the development of the air cargo business. So, the

problem lies, to a significant extent, in the lack of investments in developing aerodrome networks.

As for ATM, EurAsEC member states need to complete the planned enlargement of ATM centres and introduction of reduced vertical separation minimums (RVSM). Satellite communication equipment also needs to be installed to link ATM centres in EurAsEC member states with their European, American and Asian counterparts.

The easing of administrative (non-physical) barriers is also critical to the development of scheduled international airfreight transportation in and through EurAsEC. These barriers can be classified as follows:

- business barriers, primarily high customs duties and taxes on aircraft purchased (including new aircraft);
- cross-border barriers for cargo traffic: lengthy customs clearance procedures for air cargo and other formalities at the member states' airports cancel out any benefits from faster delivery. Experience shows that the time taken to complete formalities is often significantly longer than the flying time; and
- regulatory barriers to market access: EurAsEC lacks an efficient market in delivering freight to third countries because of the provisions of bilateral intergovernmental air traffic agreements between EurAsEC member states.

The majority of the problems identified above can be resolved by member state governments if there is a political will to do so. The development of infrastructure requires investment, not only from governments but also from public-private partnerships. Aerodrome infrastructure must be brought in line with the latest requirements for handling large aircraft and with the ICAO Standards and Recommended Practices. This will significantly encourage the development of domestic and international traffic (including transit operations). The air transport sector is keen to simplify aircraft purchase and replacement procedures, to streamline cross-border procedures and enhance access to foreign markets, including markets in transportation between third countries.

### **PROSPECTS FOR COOPERATION BETWEEN EURASEC MEMBER STATES IN THE AVIATION SECTOR**

The experience of integration associations globally suggests that to achieve macroeconomic, trade and political goals, common transport potential must be an integral component of the single economic space and common market.

Transport (including civil aviation) is a key element of regional economic cooperation, without which the free trade area, the customs and economic unions and the common market cannot be fully developed.

The development of integration associations increases passenger and cargo traffic between member countries. By the beginning of the 21<sup>st</sup> century,

economic integration in different parts of the world has gathered pace. Civil aviation is no exception, as indicated by the development of the ICAO as an international regulator of this sector.

Multilateral cooperation in the development of international air traffic, harmonisation of commercial practices based on ICAO model agreements relating to international air traffic, and the expansion of access to the market should all be speeded up. In addition, the ICAO supports multilateral regional air traffic agreements that work to harmonise and simplify airline ownership, companies' control over their activities, non-discriminatory access to the market and other important issues.

Along with improving access to market for airlines, the removal of restrictions on investment is another important area of cooperation between countries in the civil aviation sector. Transport companies can invest more freely in businesses in other member states, buy shares in air carriers, acquire other carriers or create new integrated structures. Such practices are relatively common in the European Union, as demonstrated by Lufthansa, Air France-KLM and British Airways-Iberia.

Another important issue for regional integration is the free movement of specialists (pilots) which will enable them to find jobs in other member states of an integration association. Currently, air transport regulations in the majority of EurAsEC member states prohibit the employment of foreign pilots. This policy affects aircrews and key airline personnel (managers, chief accountants, etc.).

In this context, it is important to understand the parameters of the Common Transport Space EurAsEC is creating and to assess the role of civil aviation within it.

The Community's Interstate Council (heads of governments) approved the Blueprint for the Formation of EurAsEC Common Transport Space on January 25, 2008 (Resolution 374). The Blueprint defines the Common Transport Space as a combination of the transport systems of EurAsEC member states ensuring free movement of passengers, baggage, freight and vehicles, as well as technical and technological compatibility of transport processes, harmonised transport laws and common competition rules. The Common Transport Space covers all modes of transport, the suppliers of transport and supplementary carrier services, and all forms of ownership irrespective of the country of incorporation (EurAsEC, 2008).

In other words, the Common Transport Space includes civil aviation and EurAsEC considers international passenger and cargo traffic integral to the creation of the Common Transport Space.

Section 3.1 of the Blueprint discusses the creation of a common market in transportation services. It includes the following measures (EurAsEC, 2008):



- ensuring suppliers of transport services are operating in conditions no less favourable than those applicable to similar domestic companies;
- ensuring free transit of international passenger and cargo flows;
- harmonising the terms of passenger and cargo transportation between EurAsEC member states and third countries;
- adopting uniform approaches to commercial competition and preventing abuses of competition; and
- promoting mutual recognition of certificates, diplomas and other documents regulating access to transport operations.

The first step towards the formation of the Common Transport Space, the Customs Union, and the Single Economic Space is the creation of mechanisms to enhance cooperation in international cargo transportation within EurAsEC, upgrade infrastructure and take full advantage of transit potential.

If EurAsEC's air transport potential is fully utilised, this will do more than resolve its transport problems. Besides the positive effect it will have on the region's transport systems, it will also have a multiplier effect on macroeconomic indicators. Ultimately, it will help foster economic integration in EurAsEC and advance the Customs Union.

The development of air cargo traffic in EurAsEC must comply with ICAO Standards and Recommended Practices and should take into account the best practices of many foreign countries that successfully utilise their air transport potential (the European Union, the US and China, among others). In accordance with the priorities for the development of civil aviation and flight safety measures in the CIS approved by the CIS Council of Heads of States on November 22, 2007, the key elements of the strategy for the advancement of national air transport systems and cargo traffic in EurAsEC should be:

- a) the creation of favourable conditions for the development of air traffic;
- b) the development of airport and aerodrome infrastructure and equipment;
- c) the development of the use of airspace and ATM;
- d) the upgrading of aircraft fleets and improvement of aircraft maintenance;
- e) the improvement of flight safety and protection of civil aviation from criminal acts;
- f) the improvement of training and professional development of civil aviation personnel; and
- g) the improvement of the civil aviation legal framework.

The most important task of EurAsEC member states is to exploit to the fullest possible extent the region's geographical position as the only transit bridge between Europe and Asia and the potential of its transport infrastructure, including airports and air routes.

## CONCLUSION

The main objectives of this report were to analyse the current status of civil aviation in EurAsEC member states, focusing on international air cargo traffic, and to identify the main obstacles which stand in the way of developing air transport links within EurAsEC and the utilisation of its transit potential.

Research showed that EurAsEC member states are in the process of creating the Common Transport Space. Civil aviation accounts for only a very small part of EurAsEC's total cargo traffic. In 2010, airfreight traffic between the countries in the region accounted for 0.03% of all cargo transported (excluding by pipeline).

EurAsEC has significant transit potential. Eurasia is the shortest "transport bridge" between Europe and Asia. However, the region does not exploit its competitive advantages in this regard.

The issues identified in this report are presented only as synopses and additional research is required before recommendations can be made regarding potential socioeconomic, political and other efforts to address the range of problems affecting cooperation between EurAsEC member states.

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# 11

## Integration Processes in the Electric Power Sectors of the EDB Member States

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The objective of this article is to study integration processes in the electric power sectors of Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan. The article analyses the power sectors of the EDB member states and, in particular, changes that have occurred in recent years, key trends in the development of generating capacities and power grids, and electricity exports and imports. In addition, the article analyses joint interstate initiatives, including the future establishment of a common electric power market. Recommendations are provided on how to deepen integration in the region and foster the creation of the common electric power space, with an emphasis on the EDB's role in this process. The article is based on the EDB sector report No.15, Integration Processes in the Electric Power Sectors of the EDB Member States.

### INTRODUCTION

Being one of the primary industries, the electric power sector plays a vital role in social and economic development of any country. Therefore, it is identified as one of the priority economic sectors of all the EDB member states and of the Bank's investment and lending activities. The sector's sustainable development and robust functioning contribute, to a considerable extent, to the energy security of countries and their successful economic development.

The power sectors of the EDB member states are fairly well developed with different types of power plants, including thermal power plants (condensation

and cogeneration plants), hydropower (HPP) and pumped-storage hydropower (PSH) plants, nuclear plants (NPP), renewable energy plants and electric networks (transmission lines and substations) of various voltage classes of up to 750 kV.

The analysis has outlined a number of trends in the power sectors of the EDB member states. Some of them have already been formed, while others are just beginning to emerge. On the whole, the region has demonstrated growth in electricity consumption and production. A moderate decline was registered in the crisis year of 2009, however in 2010 electricity consumption restored and exceeded the pre-crisis level of 2008. Russia and Kazakhstan saw the largest growth, while consumption and generation declined in Kyrgyzstan and Tajikistan.

The countries under review can be divided into two groups in terms of electricity consumption: (i) those with growing gross and steadily high specific consumption (Russia, Kazakhstan and Belarus), and (ii) those with declining gross and low specific consumption (Tajikistan, Kyrgyzstan and Armenia). In general, during the period under review, the industry demonstrated stable growth in generating capacity, even in the crisis year, accelerating by the end of the period. At the same time, the expansion of Kazakhstan's generating capacity was not sufficient to meet increasing electricity demand.

The structure of capacities and their contribution to total electricity generation differs between countries depending on the availability, or lack, of certain energy resources in a given country. Fossil-fuelled thermal power plants (TPPs) dominate in the region and this situation remained practically unchanged throughout the period. Hydropower dominates in Tajikistan and Kyrgyzstan. The generation pattern varies from year to year due to stochastic HPP reservoir inflows.

The EDB member states are constructing their electrical grids and improving national infrastructures so that they are able to supply electricity to all regions, including remote ones. Despite the commissioning of new facilities, reconstruction and modernisation of existing plants, the proportion of obsolete power-generating and network equipment in the region is still high. The modernisation process needs to be speeded up. Over the period studied, exports and imports of electricity between the EDB member states were declining steadily.

In fact, the development of electricity generating facilities and power grid infrastructure in energy-deficient regions that depend on electricity imports, as well as the decline in electric power exports and imports, and outages of the interstate electrical grids reinforce electrical independence of the EDB member states and weaken integration of their power sectors.

Russia's Unified Energy System (UES) works in conjunction with the UES of Kazakhstan. The power grids of Uzbekistan, Kyrgyzstan and the southern part of Kazakhstan's UES form the Central Asian integrated power system (IPS). During the period under review, the Central Asian IPS faced numerous outages of the adjoining interstate electrical grids. As a result Tajikistan was disconnected from the Central Asian IPS and, consequently, from the unified power systems of the EDB member states. Armenia cooperates with the Iranian power system due to its geographical isolation from the post-Soviet IPS, which impedes mutually beneficial export and import of electricity and integration benefits of cooperation between the national power systems.

### **ELECTRICITY EXPORTS AND IMPORTS IN THE REGION**

Electricity exports and imports between the EDB member states were diminishing steadily in the period under consideration; exports decreased almost 30% between 2006 and 2010 and imports decreased by more than 50%. This is due to a number of factors: disagreements over gas and electricity supplies from Russia to Belarus, problems with the Central Asian IPS, fuel and energy crisis in Tajikistan and Kyrgyzstan, as well as increase in domestic consumption in Kazakhstan with subsequent decline in the country's export potential leading to Kazakhstan's transformation to a net importer of electricity.

Over the 2006–2010, Russia, Armenia and Kyrgyzstan were net exporters of electric power and Belarus, Kazakhstan and Tajikistan net importers. Kazakhstan managed to meet domestic electricity demand and become a net exporter only in the crisis year of 2009. In late 2005 and early 2006 Kazakhstan suffered an acute shortage of electricity and imported power from neighbouring countries (Podkovalnikov et al., 2010).

Belarus and Tajikistan rely on electricity imports for several reasons. For Belarus, imports are an economic necessity. It is more profitable for the country to buy electricity abroad than to produce it at its own power plants. The fuel used to generate electricity in Belarus makes its own product very expensive (Volkova et al., 2011).

In Tajikistan, hydropower plants produce the majority of the country's electricity, which is why generation varies seasonally and annually. In years when water supplies are lower, HPPs do not produce enough energy and the country has to import electricity to make up the shortfall. However, even in years of average and plentiful water supply, electricity has to be imported to meet the peak autumn and winter demand, because hydropower production is still limited and output cannot be distributed to meet varying demand over a year.

Kyrgyzstan, where generation is consistently higher than annual consumption, faces the same problems as Tajikistan during peak seasons and has to import electricity to maintain the power balance.

## Armenia

The commercial operations of the Armenian power system are limited to electricity trading with Georgia, Nagorno-Karabakh and Iran (see Table 11.1).

Country	2008		2009		2010		January-October 2011	
	Export	Import	Export	Import	Export	Import	Export	Import
Nagorno-Karabakh	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Georgia	0	0	0	19.8	0	89.4	0	117.5
Iran	359.6	337.8	335.96*	271.2*	1,061.2*	156.6*	N/A	N/A
Total	359.6	343.4	336	291	1,061.2	246	1,400	N/A
Balance	16.2		45		815.2			

**Table 11.1.**  
Electricity exports  
and imports  
by Armenia  
in 2008–2010

Source: ESI SB RAS, based on data from the National Statistical Service of the Republic of Armenia; the Electricity System Commercial Operator of Georgia (ESCO)

Note: N/A – data not available; \*estimates by the authors

The electricity exports and imports balance was more than twenty times higher in 2010 than the year earlier, increasing from 0.045 TWh to 0.815 TWh and the share of export in electricity consumption grew from 0.8% to 14.36%. In 2010 total electricity exports stood at 1,061 TWh and imports 0.246 TWh. Before 2010 the balance of Armenian electricity trade with Iran was almost at zero, as Armenia exported the power to Iran in April–September and imported in October–March. In 2010 Armenia's trade in electricity with Iran had a positive balance of 904.6 million kWh.

On May 14, 2009 Iran began supplying gas to Armenia via the Iran–Armenia gas pipeline. Under the «gas for electricity» programme, Armenia pays for Iranian gas supplies with electricity at a rate of 3 kWh per 1 m<sup>3</sup> of gas. A new unit at the Yerevan TPP, which was commissioned in 2010, is the main source of electricity exports under this programme (NIRA Aksakal News, 2011).

## Belarus

Belarus is a net importer of electricity and one of the biggest importers of Russian electric power, together with Finland and Kazakhstan. In 2008–2010 Belarus imported electricity from Russia, Ukraine, Latvia and Lithuania and exported to Poland and Lithuania (see Table 11.2).

Imported electricity accounted for 6.5% of the Belarusian power balance in 2008, 12.8% in 2009, and 7.9% in 2010. The main suppliers of electricity were Russia in 2008 and 2009 (2.2 and 2.9 billion kWh respectively) and Ukraine in 2010 (2.9 billion kWh). In 2010 Russian electricity imports fell by almost one hundred times from 2.9 to 0.032 billion kWh.

In early 2011 Belarus significantly increased imports from Russia compared to 2008 and 2009. In January–June 2011, Russian imports totalled around 1.59 billion kWh (Me-press.kiev.ua, 2011). Electric power was supplied under

**Table 11.2.**  
**Electricity exports**  
**and imports**  
**between Belarus**  
**and neighbouring**  
**countries**  
(million kWh)

	2008		2009		2010		January-October 2011	
	Export	Import	Export	Import	Export	Import	Export	Import
Russia	0	2,168.4	0	2,908	0	30.3	N/A	N/A
Ukraine	0	0.7	0	1,213.6	0	2,940.6	N/A	1926.5
Latvia	0	70.3	0	58.1	0	0	N/A	N/A
Lithuania	0	157.6	7.3	298.3	269.8	0	N/A	N/A
Poland	557.8	-	0	-	0	-	N/A	N/A
Total	557.8	2397	7.3	4478	269.8	2970	N/A	N/A
Balance	-1,839.2		-4,470.7		-2,700.2		N/A	

Source: official website of the National Statistical Committee of the Republic of Belarus.

Note: N/A – data not available

agreements on parallel operation and other contracts. The interruptions in supply in 2008, 2010 and 2011 were caused by different factors, including non-compliance with these agreements.

Along with importing power from Russia, Belarus transits Russian electricity to Kaliningrad exclave and Lithuania. The volume of electricity transit depends on commercial contracts negotiated by each of the parallel power systems (FGC, 2011). Belarus imported 4,602 million kWh from Russia (including for subsequent transit) in 2008, 4,184.7 million kWh in 2009, and 2,510.6 million kWh in 2010. Electricity transit to Kaliningrad Region from Russia through Belarus and Lithuania totalled 1.143 TWh in 2008, 1.260 TWh in 2009, and 0.915 TWh in 2010 (Government of Kaliningrad Region, 2010; Belarusian Reporter, 2010; Regional Forum, 2011). Russian electricity is transited under the Single Economic Space (SES) agreements guaranteeing access to the services of natural monopolies in the power sector, including pricing and tariff policies.

### Kazakhstan

As shown in *Table 11.3*, Kazakhstan was mostly a net importer of electricity in 2006–2010. Only in the crisis year of 2009 Kazakhstan was a net exporter, possibly because of decreased domestic consumption caused by the economic slowdown. In the first nine months of 2011, net electricity imports exceeded the 2010 figure. Electricity exports went down during the period under review.

Kazakhstan's main partner in Central Asia is Kyrgyzstan. Imports from this country are growing steadily and even outpaced Russian imports in 2010. In the first nine months of 2011, Kazakhstan imported 2.125 TWh of electricity from Kyrgyzstan (KABAR, 2011).

Before 2010 Tajikistan was a member of the Central Asian IPS and exchanged small volumes of electricity with Kazakhstan, which was transited through Kyrgyzstan. When Tajikistan was disconnected from the IPS, this exchange stopped.



Indicator	2008	2009	2010	January-September 2011
Imports	2,780.1	1,771.7	3,009.5	2,299.6
from Russia	2,205.1	584.6	1,375.6	N/A
from Kyrgyzstan	553.9	967.9	1,633.9	N/A
from Tajikistan	21.1	219.2	0	N/A
Exports	2,234.7	2,245.8	1,538	704.7
to Russia	2,213.6	2,157.4	1,538	N/A
to Kyrgyzstan	0	0	0	N/A
to Tajikistan	21.1	88.4	0	N/A
Balance, overall	-545.4	474.1	1,471.5	-1,594.9
including:				
with Russia	-8.5	-1,572.8	-162.4	-704.7
Central Asia	553.9	1,098.7	1,633.9	2,299.6
with Kyrgyzstan	553.9	967.9	1,633.9	2,125
with Tajikistan	0	130.8	0	N/A

**Table 11.3.**  
Electricity imports  
and exports by  
Kazakhstan  
(million kWh)

Source: ESI SB RAS,  
data from KOREM;  
KEGOC

Note: N/A – data not  
available

Kazakhstan is Russia's main electricity trading partner and the main exporter of electricity to Russia in the context of cooperation between the EDB and CIS member states. In 2009 and 2010 Kazakhstan accounted for 70% and 52% of Russia's electricity imports respectively. There were several reasons for the decrease in Russian imports, including an improvement in Kazakhstan's domestic electricity's links. In 2008 a new interregional high-voltage line was commissioned: the 500 kV 500 km Northern Kazakhstan–Aktobe Region line connected the Aktobe Region with electricity generation facilities in Northern Kazakhstan.

**Note:**

*In November 2008 the EDB signed a \$30.5 million seven-year loan agreement with the Batys Transit concession company to construct the Northern Kazakhstan–Aktobe Region power line. The Samruk Kazyna National Welfare Fund and KEGOC (Kazakhstan Electricity Grid Operating Company) also participated in the project.*

The increase in net power flow between Kazakhstan and Russia in 2009 was caused, to a significant extent, by the accident on the Sayano-Shushensk HPP. The emergency shutdown of the plant necessitated transmission of reserve power from the Siberian IPS and the increased use of power from the Urals and mid-Volga systems transmitted to Siberia through Kazakhstan (Energy Forecasting Agency, 2010).

Because of the limited transit capacity of the Urals-Kazakhstan-Siberia system, Kazakhstan's maintenance of the agreed power balance is vital in preventing overload on the lines by non-scheduled flows.

Table 11.4 shows the estimated transit from the Urals IPS to the Siberian IPS through Kazakhstan. Although these are estimates, they illustrate Kazakhstan's role in ensuring sustainable power supplies to Siberia and the European part of Russia.

**Table 11.4.**  
**Electricity**  
**transmission by**  
**Russia through**  
**Kazakhstan's power**  
**system (million kWh)**

Source: ESI SB RAS,  
based on data from  
KOREM; KEGOC;  
System Operator  
– Central Dispatch  
Department

Indicator	2008	2009	2010
Received by Russia from Kazakhstan	4,090	5,737	5,985
Siberian IPS	4,088	5,737	5,985
South IPS	2		
Kazakhstan's electricity exports to Russia	2,213.6	2,157.4	1,538
Total electricity transit	1,876.4	3,579.6	4,447

### Kyrgyzstan

In 2010 the balance of electricity exports and imports was 1.559 TWh (see Table 11.5). Kazakhstan was Kyrgyzstan's largest export customer. Kyrgyz exports and the net power flow were growing steadily over the period. The country also transits electricity.

**Table 11.5.**  
**Electricity exports**  
**and imports**  
**between Kyrgyzstan**  
**and neighbouring**  
**countries**  
**(million kWh)**

Source: ESI SB  
RAS, based on data  
from the National  
Statistical Committee  
of the Kyrgyz  
Republic; Statistics  
Agency under the  
President of the  
Kyrgyz Republic;  
KEGOC

Note: N/A – data not  
available

Indicator	2008	2009	2010	January- September 2011	January- September 2010 (for reference)
Import	6.9	0	76.3	N/A	N/A
Uzbekistan	6.9	insignificant	76.3	N/A	N/A
Export	578.9	1,033.8	1,635.4	N/A	N/A
Kazakhstan	555.3	968.5	1,634.6	2,125	1,100
Tajikistan	23.6	7.7	0	N/A	N/A
China	N/A	N/A	N/A	0.864	0.799
Uzbekistan	N/A	N/A	N/A	N/A	N/A
Balance	572	1,033.8	1,559.1	N/A	N/A
Transit from Tajikistan to Kazakhstan	21.1	219.2	0	N/A	N/A
Transit from Kazakhstan to Tajikistan	21.1	88.4	0	N/A	N/A

The electricity exchange between Kyrgyzstan and Tajikistan (before it was disconnected from the Central Asian IPS) took place primarily in winter when Kyrgyzstan's supplies were used to compensate for power deficit in the north of Tajikistan. Small amounts of electricity were exported to Uzbekistan under intergovernmental irrigation agreements covering water and power exchange (Inogate, 2011).

Since December 2009, partly because of Tajikistan's disconnection from the system, Kyrgyzstan has been supplying electricity primarily to Kazakhstan and China. The imports have been insignificant. The Kyrgyz power system, despite domestic shortages, remains a net exporter of electricity.

## Russia

Table 11.6 shows Russia's exports and imports of electricity. The decline in Russia's trade with neighbouring countries in 2009, compared to 2008, resulted

Indicator	2008	2009	2010	January-September 2011	January-September 2010 (for reference)
<b>Neighbouring countries</b>					
Export (total)	9,334.7	5,074.6	6,898.8	N/A	N/A
including: Ukraine	1,110.9	22	32		
Belarus	2,168.4	2,908	30.3		
Latvia	1,617.9	656	7		
Lithuania	1561	410	5,106		
Kazakhstan	2,205.1	584.6	1,375.6		
Georgia	560.1	348	211.9	205.2	38.6
Azerbaijan	111.3	21	18		
South Ossetia		125	118		
Import (total)	3,079.3	3,002.3	2,902.1	N/A	N/A
including: Kazakhstan	2,213.6	2,119	1,498		
Ukraine		0.5	81		
Lithuania	97.5	199	3		
Georgia	432.7	525.8	1,117.1	574.5	1,051.8
Azerbaijan	335.5	158	203		
Balance	6,255.4	2,072.3	3,996.7		
<b>Other countries</b>					
Export (total)	11,254.9	12,962	13,047	9,611.3	N/A
including: Finland	10,883	11,708	11,639	8,480	8,496
Norway	176.5	227	211	131	155
Mongolia	195.4	182	214	206	
China	0	845	983	925.3	
Import, total	21	21	21	N/A	N/A
Mongolia	21	21	21		
Balance	11,233.9	12,941	13,026	N/A	N/A
<b>Total</b>					
Export	20,589.6	18,036.6	19,945.8	16,576	13,523
Import	3,100.3	3,023.3	2,923.1	995.5	1,390.7
Balance	17,638.1	15,013.3	17,022.7	15,580	12,132.5

**Table 11.6.**  
Russian electricity  
exports and imports  
(million kWh)

Source: ESI SB RAS, based on data from Belenergo, CIS Interstate Statistical Committee, Russia's Federal State Statistics Service, INTER RAO UES; KOREM, KEGOC, System Operator – Central Dispatch Department, Electricity System Commercial Operator (ESCO) of Georgia, European Network of Transmission System Operators for Electricity (ENTSOE).

Note: N/A – data not available

from an overall reduction in consumption in other countries because of the global financial crisis. In 2010 Russia's net power flow increased by more than 10% year-on-year to 17.02 billion kWh. The main importers of Russian electricity in 2010 were Finland (58.4%), Lithuania (25.6%), and Kazakhstan (6.9%). Small volumes were transmitted to Norway, Belarus, Latvia, Ukraine, South Ossetia and Mongolia. The exchanges with Georgia and Azerbaijan were seasonal. The redistribution of supplies between the countries was caused by two main factors: the decommissioning in 2010 of the Ignalina NPP (Lithuania) and the repair, during that year, of the 750 kV power line between Smolensk NPP and the Belorusskaya substation in Belarus (INTER RAO UES, 2011).

In addition to exports and imports shown in the table, Russia supplied electricity (without importing it) from its own generating facilities located in other countries: it supplied Iran from the Hrazdan TPP in Armenia and Romania from the Moldavskaya GRES in Moldova. In 2010 Russia began supplying Turkey with electricity transited via Georgia (Energ-news.ru, 2010; INTER RAO UES, 2011).

Exports grew and imports declined in 2011, creating a record high net power flow for the period 2008–2011. In the first nine months of 2011, the balance of exports and imports reached 15.6 TWh, up almost 3.5 TWh year-on-year. The increase in exports was due in particular to the restoration of supplies to Belarus, increased exports to China and Mongolia, and the launch of the second unit at the Kaliningrad TPP in 2010 (which made it possible to export its excess production to Lithuania and Belarus).

Belarus is Russia's traditional partner, yet cooperation between the two in 2008–2010 was far from stable. Exports and imports between Russia and Kazakhstan did not change drastically over the same period, but the trend was downward. Belarus and Kazakhstan accounted for around 50% of Russian exports to neighbouring countries in 2008. This increased to almost 70% in 2009, but dropped to 20% in 2010 (because of the decrease in imports by Belarus). Kazakhstan supplied almost 70% of Russian imports from neighbouring countries in 2008–2009, falling to 50% in 2010.

### **Tajikistan**

As shown in *Table 11.7* below, in 2008–2009 Tajikistan's most significant electricity exchanges were with Uzbekistan and Turkmenistan, while its exchange with Kazakhstan and Kyrgyzstan was lower.

Before it was disconnected from the Central Asian IPS, Tajikistan supplied electricity each year to the Surxondaryo Province in southern Uzbekistan, and received the same amount of electricity in its northern Sughd Province from Uzbekistan's Syrdarya GRES. Tajikistan and Uzbekistan also exchanged electricity as allowed by their joint responsibility to regulate water discharge

	2008	2009	2010	January- October 2011	January-October 2010 (for reference)
<b>Import</b>	<b>5,229.6</b>	<b>4,168.7</b>	<b>321.4</b>	<b>65</b>	<b>310.5</b>
Uzbekistan	3,984.2	3,404.6	321.4	N/A	N/A
Turkmenistan	1,200.7	668	0	N/A	N/A
Kazakhstan	21.1	88.4	0	N/A	N/A
Kyrgyzstan	23.6	7.7	0	N/A	N/A
<b>Export</b>	<b>4,346.1</b>	<b>4,227.3</b>	<b>179.8</b>	<b>136.6</b>	<b>153.4</b>
Uzbekistan	4,279.1	3,933.8	0	N/A	N/A
Kazakhstan	21.1	219.2		N/A	N/A
Kyrgyzstan	0	0		N/A	N/A
Afghanistan	45.9	74.3	179.8	N/A	N/A
<b>Balance</b>	<b>-883.5</b>	<b>58.6</b>	<b>-141.6</b>	<b>71.6</b>	<b>-157.1</b>

**Table 11.7.**  
**Electricity exports**  
**and imports by**  
**Tajikistan**  
(million kWh)

Source: Petrov (2010); Abdul Raziq Samadi (2011); official website of the Agency on Statistics under the President the Republic of Tajikistan (<http://www.stat.tj>).

Note: N/A – data not available

from the Kairakkum reservoir. During the crop-cultivation season Tajikistan supplied water and surplus electricity to Uzbekistan and Uzbekistan returned the same amount of electricity to Tajikistan in winter when Tajikistan suffered power shortages (TopTJ.com, 2009). Kyrgyzstan and Tajikistan exchanged electricity primarily in winter.

Turkmenistan was an important electricity supplier. Until the end of April 2009, under a five-year intergovernmental agreement signed in 2007, Tajikistan imported Turkmen electricity from September to May of each year, transiting it through Uzbekistan. In 2009 Tajikistan failed to reach a transit agreement with Uzbekenergo.

In 2010 Tajikistan imported small volumes of electricity from Uzbekistan only. Uzbekistan continued to supply 360 GWh a year to Tajikistan's remote northern regions, via 220 kV and 110 kV transmission lines. The supplies were prepaid every ten days. Tajikistan exports electricity to Afghanistan only. At present, its daily exports stand at 15 MW and cost \$0.035 per kWh. According to forecasts, exports may exceed 1 billion kWh in spring and summer (Avesta. tj, 2011).

## MUTUAL INVESTMENTS IN 2008-2011

The Agreement on the Promotion and Mutual Protection of Investments signed by EurAsEC member states in December 2008 has had a positive effect on mutual investment.

Establishing long-term relationships can depend on mutual investment and the purchase of power facilities in the EDB member states, and on mutual supplies of power and electrical equipment at sites under construction (including life-time maintenance of equipment by suppliers). It should be noted that investors and

suppliers from third countries, including the US and China who are important competitors, play significant role in developing the energy markets of the EDB member states.

Facility	Company	Ownership	Capacity	Investment, timeframes	Note
<b>Armenia</b>					
Armenian NPP	INTER RAO UES	trust management	815 (407.5*) MW		In November 2011 Inter RAO began negotiations on the termination of management
Hrazdan TPP	INTER RAO UES	100% owner	1,110 MW		Until 2011 the plant was owned by Rosneftegas (100% minus one share owned by Rosimuschestvo)
Hrazdan TPP (Unit 5)	ArmRosgasprom	100% owner	480 MW	ArmRosgasprom's investment programme in Armenia for 2009-2011 (\$169.6 million)	Construction reaching completion. ArmRosgasprom is an Armenian-Russian joint venture 80% owned by Gazprom
Sevan-Hrazdan cascade of HPPs	RusHydro	90% owner	561.4 MW	Investment programme for 2008-2010 (\$30 million)	International Energy Corporation, until 2011 owned by Inter RAO UES
Electrical Networks of Armenia	INTER RAO UES	100% owner	29,600 km	Investment programme for 2009-2011 (\$180.3 million)	In March 2009 INTER RAO UES consolidated 100% of shares; before that INTER RAO UES owned 67%
<b>Kazakhstan</b>					
Ekibastuz GRES-2 (Kazakhstan)	INTER RAO UES	50% owner	1,000 MW	Construction of a 500 MW Unit 3 (\$770 million)	Financed by Vnesheconombank, EDB and Halyk bank of Kazakhstan
<b>Kyrgyzstan</b>					
Kambarata-1 HPP	INTER RAO UES	Kyrgyz-Russian JV (50%/50%)	1,900 (0*) MW	A \$1.7 billion loan from Russia, starting 2011	
Kambarata-2 HPP			360 (110*) MW	A \$300 million loan from Russia, 2009	
<b>Tajikistan</b>					
Sangtuda-1 HPP	Rosatom (60.13%); INTER RAO UES (14.87%)	Russian-Tajik JV (75%/25%)	670 MW	16 billion roubles invested by Russia in construction in 2005-2009	Russia owns 75% of shares of Sangtuda-1 HPP

**Table 11.8.**  
Russia's foreign electric power assets and investments (as of November 2011)

Source: ESI SB RAS

Note: \* – operating

**Table 11.9.**

Development, production and supply of electric power equipment and design documents by Russian companies (November 2011)

Facility	Company	Form of contract	Equipment	Investments, timeframes
<b>Armenia</b>				
Armenian NPP	TVEL JSC	Supply and research and engineering support to the use of nuclear fuel	Nuclear fuel for the plant	Long-term contract
	ARMZ Uranium Holding	Geological exploration		
	Rosatom	Technical assistance from IAEA to improve safety at the plant		2,040 million roubles in 2008 (financing from Russia's contribution to the IAEA extra-budgetary fund)
	Rosatom	Design of a new unit at the plant	Design documents	2010 – to date
<b>Belarus</b>				
Lukoml GRES	Power Machines	Manufacture and supply of equipment	Manufacture and supply of equipment for the modernisation of a 300 MW Unit 3	Contract value \$7 million, 2010
Vitebsk TPP	Power Machines	Manufacture and supply of equipment	Manufacture and shipment of a 50 MW steam turbine PT-40/50-8.8-1.0 and a generator	2010-2011, completed
Polotsk HPP	Technopromexport	Design, construction, supply and installation of equipment, start-up and commissioning of a hydro unit	Construction of a 21.6 MW hydropower plant	A loan from EDB in the amount of 450.3 billion Belarusian roubles
<b>Kazakhstan</b>				
Ekibastuz GRES-2	Consortium of COTES-Kazakhstan and COTES (Novosibirsk)	Preparation of Unit 3 design estimates	Design documents	2010 – to date

Facility	Company	Form of contract	Equipment	Investments, timeframes
Kazakhmys Corp. GRES	Power Machines	Manufacture and supply of equipment	Steam turbine K-55-90 and turbine generator T3FP-63	2008
Karaganda TPP-3	Power Machines	Manufacture and supply of equipment	Steam turbine T-120/140-12.8 (150 MW), turbine generator (160 MW) with an excitation system, and auxiliary equipment for the turbine generator	Contracted in 2010, supplied in 2011
Bukhtarma HPP (reconstruction)	Power Machines	Modernisation	82 MW hydro turbine	2009
Ust-Kamenogorsk HPP	Elsib	Manufacture and supply of equipment	hydro-generator SV 1160/180/72	First half of 2011
Astana TPP-2	The Ural Turbine Works		Steam turbine T-120/130-12.8-8 MO	First half of 2011
Kyrgyzstan				
Kambarata-2 HPP	Leningrad Metal Works	Manufacture and supply of equipment	Two 122.5 MW hydro turbines	2008
Tajikistan				
Sangtuda-1 HPP	Power Machines	Manufacture and supply of equipment	186.1 MW hydro-generator SV 1260/182-60, hydro turbines RO-75-V-600	2007-2008

Source: ESI SB RAS



## Russia and Armenia

Russia's INTER RAO UES owns 100% of the Electrical Networks of Armenia, an Armenian monopoly distributor of electric power. INTER RAO'S investment programme for 2009-2010 included \$180.3 million for special programmes and enhancement of its services (Ministry of Economic Development of the Russian Federation, 2011). In 2010 Electrical Networks of Armenia reconstructed sixteen substations with a voltage of 6/35/110 kV.

INTER RAO UES investment programme for 2008-2010 included spending of \$30 million to upgrade the Yerevan, Argel and Arzni HPPs and overhaul the Sevan and Kanaker HPPs. The overhaul of Sevan and Kanaker has been completed and the modernisation of the other facilities is under way. In the summer of 2010, the dam height at Lake Sevan was elevated and this was expected to increase electricity generation by the Sevan-Hrazdan cascade. The company is expected to invest around \$40 million by 2013, including \$20 million to modernise the HPPs (INTER RAO UES, 2011b).

Rosneftgas owns four units at the Hrazdan Energy Company (Hrazdan TPP), with a total installed capacity of 1,100 MW. In 2002 ownership of the Hrazdan plant was transferred to Russia as payment of the Armenian government's \$31 million debt (Oilcapital.ru, 2009). The Russian government transferred 100% of shares in the company to INTER RAO UES (except Unit 5) (News.am, 2011b).

The construction of Unit 5 is under way at the Hrazdan plant. It is owned by ArmRosgasprom, an Armenian-Russian JV with 80% of stock owned by Gazprom. ArmRosgasprom's investment programme in Armenia for 2009-2011 totalled \$169.6 million (Ministry of Economic Development, 2011).

Russian-Armenian cooperation in nuclear power generation is executed under the Intergovernmental Agreement on Cooperation in the Peaceful Use of Nuclear Energy dated September 25, 2000. Rosatom is responsible for coordinating the participation of Russian organisations in the execution of four technical cooperation projects being carried out by the International Atomic Energy Agency (IAEA) to improve safety at the plant. These projects are financed by Russia's contribution to the IAEA's extra-budgetary fund. In 2008, to finance safety improvements at the plant, Russia transferred 2.04 billion roubles to Armenia from the IAEA fund to support projects implemented under the IAEA's Technical Cooperation Programme for 2009-2011 (Atomenergoprom, 2011).

On August 20, 2010 the governments of Russia and Armenia signed the Agreement on Cooperation in Constructing New Units at the Nuclear Power Plant in Armenia (Atomenergoprom, 2011). The first facility to be constructed is a 1,000 MW generating unit. According to the Armenian Ministry of Energy, the project's estimated cost amounted to \$5-\$6 billion (BigpowerNews.ru, 2011). In 2006, the Armenian parliament abolished the state's monopoly right to own new nuclear power units in order to attract foreign capital to the project.

Construction was scheduled to begin in 2011 and the new unit is due to be commissioned by 2017 (BigpowerNews. ru, 2011).

### **Russia and Belarus**

The investment cooperation between Russia and Belarus in 2008-2011 focused on different areas, including the supply of power equipment. Since 2005, Power Machines<sup>1</sup> has been involved in the upgrade of Belarus' largest TPP, the Lukoml GRES. In 2010 Power Machines OJSC and Vitebskenergo Republican Unitary Enterprise signed a contract for the manufacture and supply of equipment to upgrade Unit 3 of the Lukoml GRES, with a contract value estimated at \$7 million (Power Machines, 2011; Energyland.info, 2010).

Under the agreement signed in August 2010 with Vitebskenergo, the Kaluga Turbine Works (part of the Power Machines group) manufactured and supplied equipment for the Vitebsk TPP. The group also provided installation, start-up and training (Bigpowernews.ru, 2011).

Vitebskenergo is implementing construction of the 21.6 MW Polotsk HPP on the Western Dvina, due to be commissioned in 2016. This project is implemented under the State Programme for Innovative Development of the Republic of Belarus for 2011-2015, and has an estimated cost of 450.3 billion Belarusian roubles (Bigpowernews.ru, 2011). After the purchase of the main equipment a contract was concluded with Technopromexport (part of the Russian Technologies State Corporation) for the construction of a hydro unit at the Polotsk plant. Technopromexport is to provide design, construction, supply and installation of equipment, start-up and commissioning.

#### **Note:**

*EDB and Vitebskenergo signed a ten-year loan agreement to finance the project in November 2010. The power plant will generate 112 million kWh a year. The project cost is \$1.427 billion, including \$99.8 million provided by the EDB.*

On March 15, 2011, at a Council of Ministers session in Minsk, the governments of Russia and Belarus signed an agreement to construct a nuclear power plant in Belarus. The state enterprise «Directorate for Nuclear Power Plant Construction» (Belarus) and Atomstroyexport JSC (Russia) also signed a contract in 2011. The parties agreed that construction costs would be based on the same pricing formula as those used for nuclear plants built in Russia (Energy Strategy, 2011). Loan financing for construction will be extended once the parties have signed an agreement on a Russian government loan. The estimated total investment (and loan amount respectively) for the Belarusian NPP will make up \$6-6.5

<sup>1</sup> Russia's leading producer of power equipment, uniting large electrical engineering enterprises, including the Leningrad Metal Works, Energosila, the Kaluga Turbine Works, and the Turbine Blades Plant, among others.

billion. Social, transport and production infrastructure will cost an additional \$2.5-3 billion (Atominfo.ru, 2011).

### **Russia and Kazakhstan**

The construction of Unit 3 at Ekibastuz GRES-2, which is jointly owned by Samruk Energo (50%) and INTER RAO UES (50%), will raise the plant's capacity by 50% to 1,500 MW.

#### **Note:**

*The governments of Russia and Kazakhstan signed an agreement on the construction and operation of Unit 3 at Ekibastuz GRES-2 on September 11, 2009. The project cost is estimated at \$800 million. Financing terms were agreed in the summer of 2010 in Kazakhstan. The document was signed by EDB, Vnesheconombank, Ekibastuz GRES-2 JSC, Samruk Energo and INTER RAO UES. In accordance with the agreement, EDB and Vnesheconombank will provide a multi-currency 15-year loan for a total of \$770 million, on a parity basis. Halyk Bank of Kazakhstan also became party to the agreement in June 2011 as the third lender.*

In addition, Bogatyr Komir, a Kazakh-Russian JV, is developing the Bogatyr coal deposit which supplies coal to Ekibastuz GRES-2. This company is owned by Samruk Kazyna and RUSAL.

#### **Note:**

*EDB agreed to finance Kazakhstan's largest coal producer, Bogatyr Komir. EDB's seven-year loan for a total of up to \$50 million will be used to purchase up-to-date equipment and machinery. The increase in coal supplies is expected to boost mutual trade between Russia and Kazakhstan by \$30 million a year. In addition, about 80% of the required equipment (worth around \$40 million) will be supplied to the project by Russian enterprises.*

In June 2010 Karaganda Energotsentr (Kazakhstan) contracted Power Machines to manufacture and supply equipment for a 150 MW fifth unit (currently under construction) at Karaganda TPP-3. In March 2011 the turbine generator was commissioned (Bigpowernews.ru, 2011). Power Machines also provided supervision, start-up and training.

In June 2011 a long-term programme for the re-equipment and reconstruction of the Bukhtarma HPP, which is being implemented since 2001, was completed. The ninth power unit (Unit 7 at the plant) and a turbine upgraded by Power Machines were commissioned. As a result the plant's capacity rose from 75 MW to 82 MW (Power Machines, 2011b).

Kazakhstan and Russia are keen to develop and integrate their nuclear sectors. EDB's Sector Report No.11, Russian and Kazakh Nuclear Energy: Trends in Economic Cooperation, provides more information on this issue.

## **Russia and Kyrgyzstan**

Russian investment in the Kyrgyz economy consists mainly of the setting up the subsidiary companies and joint ventures in strategic sectors. In April 2009, INTER RAO UES and Kyrgyzstan's Electric Power Plants JSC agreed to build the 1,900 MW Kambarata-1 HPP as a 50/50 joint venture (Alemar, 2009). The construction cost was estimated at \$3 billion (Dw-world.de, 2010). Russia was expected to provide a \$2 billion loan from the federal budget and INTER RAO UES' funds.

In May 2011 a Kyrgyz-Russian working group was set up to control the implementation of the project. In October 2011 Russia confirmed its intention to provide a \$2.1 billion loan for building the Kambarata-1 HPP and the upper Naryn cascade of HPPs (four hydropower plants with a capacity of up to 300 MW) for a term of 20 years, including the 8-year grace period and the annual interest rate of 3% (24.kg, 2011). The majority of the loan (\$1.7 billion) is likely to be spent on the construction of Kambarata-1 HPP.

Russia is also partnering with Kyrgyzstan in the completion of Kambarata-2 HPP. Construction of the 360 MW plant (three 120 MW units) began in 1986 but was suspended in the early 1990s when funds ran out. Leningrad Metal Works (Power Machines Group) supplied the first unit. Funds injected by the Kyrgyz government and loaned by Russia in 2009 were invested into the project. Now the plant's capacity is 120 MW, and full generating capacity should be reached in 2015. A total of \$195.164 million were allocated for research, design, construction and equipment for Kambarata-2 HPP, including \$77 million from the Kyrgyz budget, over \$8.505 million from Kyrgyzstan's Electric Power Plants JSC (general originator of the project) own funds, and a loan of \$109.65 million (Government of the Kyrgyz Republic, 2011).

RusHydro and INTER RAO UES, together with Kyrgyzstan's Electric Power Plants JSC, are studying the possibilities for the development of the Naryn River hydro potential particularly along its upper reach, and conducting feasibility studies for both large and small hydro projects (Cleandex.ru, 2011).

## **Russia and Tajikistan**

In February 2005 Sangtuda-1 HPP, a Russian-Tajik JV, was created with a view to the plant's construction and its subsequent operation. Russia invested over 16 billion roubles in the HPP construction (Sangtuda-1 HPP, 2011). In 2010 the plant generated 1.633 billion kWh of electricity. As at June 1, 2011, Rosatomprom owned a 60.13% stake in Sangtuda-1 HPP, the Tajik government had 25% plus one share, and INTER RAO UES owned 14.87% (Sangtuda-1 HPP, 2011).

The construction of the Rogun HPP, with an installed capacity of 3.6 GW and long-term average production of 13.1 TWh a year, was suspended after

the collapse of the Soviet Union. Located on the Vakhsh River, the plant was expected to become the largest hydropower plant in Central Asia. The commissioning of all six units will require approximately \$4 billion. INTER RAO UES and RUSAL considered a possibility of taking part in the completion of the Rogun HPP, however it was not implemented. Russian-Tajik cooperation in this project is currently limited to the drafting of engineering documents for the hydro unit (Hydroproject, 2011).

### **Russia, Kyrgyzstan and Tajikistan**

Kyrgyzstan, Tajikistan, Afghanistan and Pakistan are the four countries cooperating in the CASA-1000 project involving the construction of two high-voltage interstate power transmission lines and three substations in Kabul, Peshawar and Sangtuda to export electricity from Tajikistan and Kyrgyzstan to Afghanistan and Pakistan. INTER RAO UES also plans to take part in this project. The project was assessed positively by the World Bank. Its preliminary value is estimated at \$1.5-\$2 billion. Russia intends to invest at least \$500 million in CASA-1000 (Bigpowernews.ru, 2011).

### **Kazakhstan and Kyrgyzstan**

In June 2011 the countries signed a protocol to set up a Kyrgyz-Kazakh investment fund and a number of other documents on cooperation (Fergananews.com, 2011). The \$100 million investment fund will be used to finance industrial projects in Kyrgyzstan, including those in the power sector. Kazakhstan intends to invest up to \$12 million to help Kyrgyzstan meet its high demand for power and heat next autumn and winter.

The National Electrical Grid of Kyrgyzstan and Kazakhstan's KEGOC have also signed an agreement on cooperation in the power sector.

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The above analysis illustrates that mutual investments in the power sectors of EDB member states over the 2006-2010 period were primarily unilateral and mostly Russian. This was also one of the conclusions of the EDB's study in 2008 (Vinokurov, 2008) and the situation has not changed since. Investment in power facilities are backed by supplies of electrical and power-generating equipment, the majority of which is also produced in Russia.

Clearly, integration between the EDB member states is gathering pace.

### **IMPLEMENTED SYSTEM EFFECTS**

Electricity exchanges do have an effect on the integrated national power systems of the EDB member states. These effects illustrate, to a certain extent, the level of integration of their power systems. At present, Belarus, Russia, Kazakhstan and Kyrgyzstan are contributing to the evolution of power system's integration

while Armenia and Tajikistan (following its isolation from the Central Asian IPS in late 2009) operate independently of the integrated system.

Armenia works in tandem with the Iranian power system to cover seasonal high demand (NARUC, 2011). Armenia's peak season is in the winter while Iran's is in the summer. The countries exchange seasonal flows of electricity by loading their plants during low-demand periods and assisting each other in covering peak loads.

Belarus is reducing expenditure on the fuel necessary to generate electricity by increasing its imports from Russia. This helps minimise electricity prices for Belarusian consumers, thus, achieving a regime effect (Volkova et al., 2011a). Russia generates an economic effect through its electricity exports.

Cooperation between Russia and Belarus will have a more substantial regime effect in the future. With the commissioning of the Belarusian NPP, a base load power plant, Belarus will face a greater challenge of covering the variations in demand through the day. At night Belarus will need to transmit surplus electricity to neighbouring countries, including Russia, which should help to reduce cycle capacity problems (Volkova et al., 2011a).

Central Asian countries and Russia (partly through Kazakhstan's grids) used Kyrgyz and, until 2009, Tajik hydropower resources (KOREM, 2011). This helped improve the operating rates at several power plants in these countries and reduced generating costs generally. Consumer prices for electricity were lowered to a minimum level to achieve a regime effect, which, due to political tensions between the Central Asian states, was not fully implemented and is currently not realised in practice.

In recent years Tajikistan has not had an opportunity to supply its seasonal surpluses of electricity to the Central Asian IPS, but did attempt to supply to Afghanistan, thereby achieving regime effects outside the post-Soviet space (Ministry of Energy and Industry, 2011a).

Electricity exchanges between the Siberian IPS and the Urals IPS via KEGOC's (Kazakhstan) grids have usually been carried out from Siberia to the Urals (European part of Russia) during evening-time peak hours and from the Urals to Siberia during night off-peak hours in the European part of Russia. This helped to implement a regime effect of regulating daily demand in the European part of Russia through the exchange of electricity between these two regions also using Kazakhstan's northern grids.

The cooperation between the national power systems of the EDB member states has helped to improve the reliability of power supplies to consumers (e.g., using Kazakhstan's northern electrical grids to transmit electricity from the European part of Russia and the Urals to the Siberian IPS to cover its shortages caused by the Sayano-Shushensk HPP accident in 2009) (Volkova et al., 2011a).

In 2008, in order to mitigate power shortages resulting from an accident at Belarus' Lukoml GRES, the lacking amount of electricity was supplied by Russia, Lithuania and Latvia (Lenta.ru, 2008) via the power plants in the north-western IPS and the Baltic States that were loaded following the instructions of the System Operator of the Unified Energy System (UES System Operator, 2008).

The power systems of the EDB member states cover four time zones and daily peak hours in different systems do not coincide. It is expected that, given socioeconomic development, the winter peak loads in Kyrgyzstan and South Kazakhstan will be replaced by summer peak demand (Belyayev et al., 2008). There will be a similar effect in Tajikistan. The unification of systems with winter and summer peak loads will have significant integration effects, saving generating capacity and lowering the cost of construction and operation of generating facilities. Given the daily differences in peak demand and the variation in generating capacities between the national power systems, closer cooperation between Central Asian EDB member states, primarily with Russia, where peak demand is in winter, is expected to produce the greatest capacity-saving and regime integration effects for all countries.

### **INTERSTATE INITIATIVES ON ESTABLISHING A COMMON CIS ELECTRICITY MARKET**

The power systems of the CIS countries emerged after the collapse of the USSR when the Soviet power complex was divided between them. Integration processes in the CIS power sectors began on February 14, 1992 when the Agreement on the Coordination of Interstate Relations in the Field of Electric Power in the CIS (CIS, 1992) was signed by the Heads of States. In accordance with the agreement, the countries formed the CIS Electric Energy Council (Mishuk, 2008).

To ensure the reliable operation of the power systems and to create a basis for mutually beneficial cooperation, the CIS Electric Energy Council approved the Agreement on Parallel Operation of the CIS Power Grids, which defined the common principles of parallel operation (Mishuk, 2008).

On November 26, 1998, the Agreement on Ensuring Parallel Operation of the Electric Power Systems of the CIS Member States was signed (CIS, 1998). This was the very first legal instrument (Mishuk, 2011) governing interaction between countries and enterprises regarding the parallel operation of the power grids on commercial terms. The agreement was signed by Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Uzbekistan and Ukraine (the latter with a modest proviso). Within the framework of the Agreement the parties reached corresponding bilateral and multilateral agreements (CIS, 1998).

So, on November 22, 1999, Belarus and Russia signed an agreement to create an integrated power system (Agreement, 1999); on June 15, 2000 the parallel



operation of the Kazakh and Russian UES was reinstated; and in September 2000 the power grids of Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan that were parties to the Central Asian IPS together with Kazakhstan's electricity system launched their first time ever parallel operation. By 2001 the Agreement on Ensuring Parallel Operation of the Electric Power Systems of the CIS Member States had made it possible to establish an integrated power system between the CIS member states, which subsequently enabled the power grids of the CIS countries (except Armenia) to work in parallel mode (Mishuk, 2011).

On January 25, 2000 twelve countries signed the Agreement on the Transit of Electric Power among the CIS Member States (CIS, 2000). Pursuant to the agreement (CIS, 1998), the Council of Heads of States approved the Concept for the Formation of the Common Electric Power Market of the CIS Member States (CIS, 2005a).

The Concept encompasses shared approaches to the common electric power market in the CIS. It takes into account the key principles of the unification and liberalisation of the European power markets as embodied in European Parliament and European Council directives and provides the basis for further regulation in this area.

The main objective of the Concept is to create a common electric power market in the CIS based on the power systems that work in parallel and on the principles of national equality, fair competition, and mutual benefit.

The Concept defines a functional structure of a future common electric power market based on the following relationships between participants:

- wholesale purchases and sales of electricity with independent pricing agreed between buyers and sellers;
- a centralised electricity market;
- a balancing market; and
- a market for system and auxiliary services, including a mechanism for using power reserves, regulating capacity and maintaining the energy balance.

On May 30, 2008 the EurAsEC Energy Policy Council approved the draft Concept, which was ratified by heads of governments on December 12, 2008.

On May 25, 2007 six CIS countries (Russia, Kazakhstan, Belarus, Kyrgyzstan, Tajikistan and Armenia) drafted the Agreement on the Formation of the Common CIS Electric Power Market. However, Ukraine, Azerbaijan, Turkmenistan, Uzbekistan, Georgia and Moldova refused to sign up to the new document and the parties made a decision to continue operations within the framework of the previously signed agreement. In order to establish a common electric power market, the member countries must undertake to maintain the energy balance



and ensure mutual reserves of capacity. This will improve the reliability of power supplies and ensure optimal use of fuel, energy and hydropower resources. In addition, the countries will need to provide electricity transit through their territories.

By creating the common electric power market, the CIS countries plan to gradually open up their domestic markets to each other. This will make it possible for suppliers or buyers of electricity in one country to access the transmission system, select counterparties, and enter into contracts in another country.

The 32<sup>nd</sup> CIS Electric Energy Council decided that the common electric power market would be formed in three stages.

The first stage will create trade in electricity between the CIS member states using international transmission lines and transit via the power systems of third countries. It will increase the number of participants on national markets; boost the development of a day-ahead market; and ensure free electricity pricing on national markets.

The second stage involves the emergence of competing national power markets in CIS countries, liberalisation of electricity exports and imports, and coordination of national grids and commercial operators.

The third stage implies the full launch of the common electric power market, based on uniform rules for all participants.

On November 22, 2007 twelve countries, including Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan, signed the Agreement on Harmonisation of Customs Procedures for the Transmission of Electric Power across the Customs Borders of the CIS Member States (CIS, 2007a). This agreement aims to harmonise and simplify customs procedures for transmitting electricity between national power grids. The standard procedure for power transfer is specified in a customs declaration once the base period expires and there are special rules for the customs clearance and control of power flows through borders.

The approval in 2008 of the CIS Economic Development Strategy for a period to 2020 became an important milestone in the coordination of the power sectors of the CIS member countries.

On November 20, 2009 the CIS member states signed an agreement on cooperation in operating interstate power transmission lines, which set forth the requirements for reliable and efficient grid operation to coordinate electricity transit.

The agreements signed have defined the prospects for electricity cooperation between the CIS countries, including:

- the sustainable and predictable development of international trade in electricity for a relatively long term; and
- economic efficiency for all participants.

Each country's energy policy is largely shaped by an energy strategy which prioritises long-term international cooperation. This shared priority recognises the desire to ensure the most efficient use of the energy potential of each country so that they can be integrated into the global power market and consolidate its position, and derive the greatest possible benefit for the national economy.

Achieving the strategic objectives of CIS member states depends on the following:

- the countries' national interests should be taken into account in shaping the common electric power market to ensure predictable development of their electrical grids;
- the common electric power market should reliably meet demand and ensure, inter alia, the reasonable pricing of exports;
- mutual penetration of national power markets by electricity companies should be guaranteed; and
- effective international cooperation should be developed in the sector.

The development of the CIS power sector can be efficiently coordinated only by harmonising the main objectives of the long-term energy policies by the CIS member states (Shmatko, 2009).

On March 18-19, 2010 the Coordination Council for the Implementation of the Strategy of the CIS Member States for Interaction and Cooperation in the Field of Electric Energy approved new organisational, legal, technological and economic principles of the parallel operation of the CIS power grids. Moreover, in 2010 the CIS Electric Energy Council adopted a master plan for the establishment of the common electric power market of the CIS member states (Mishuk, 2011).

At present, eleven out of twelve CIS power grids operate in parallel mode with the Baltic States. Efforts are being made to prepare the CIS and Baltic States' IPS to operate in parallel with the Trans-European Synchronously Interconnected Electric Power System (TESIS).

To date, the CIS has adopted over twenty basic interstate agreements and regulations governing joint interstate initiatives formulated by the CIS Electric Energy Council with regard to the following:

- electricity transit;
- mutual assistance in case of accidents or other emergencies at power facilities;
- energy efficiency and conservation;
- creation and efficient use of reserve resources;
- formation of the common electric power market;
- setting of a common time for reading electricity meters on interstate power transmission lines; and
- harmonisation of customs procedures for the cross-border transmission of electricity and operation of interstate power transmission lines within national grids.

### **BARRIERS TO CREATING THE COMMON ELECTRIC POWER MARKET**

Many agreements on parallel operation of the power systems of different countries were signed, including the October 2011 agreement on the CIS free trade area which concerns, among other things, the power sector. However, such initiatives have faced difficulties in recent years (Vinokurov, 2008), which prevent them achieving their goal quickly.

One of the challenges is historical: the power sectors of these countries vary in their level of development and structure. This is a result of the centralised approach to locating generating facilities and developing electricity grids under the Soviet common power system. Power stations were built to facilitate the centralised supply of power to large areas, regardless of the administrative borders between the Soviet republics. Generating capacity was determined according to the demand in each of these areas. Transmission lines were designed and built to distribute the electricity produced by these power plants to different power centres, also regardless of borders. After the dissolution of the Soviet Union, many transmission lines became trans-border lines. Instead of system-forming role, they are used to export and import electricity at agreed prices.

There is still a need to coordinate the development of generating facilities and electrical grids in certain CIS countries. Although historical differences in their available energy resources was a driver for cooperation and the formation of trade ties between them in the power sector, it complicates the coordination of investment policies because of the energy security requirements which arise in the context of liberalisation of national economies and power sectors.

The problems associated with creating a common CIS electricity market are also linked to the power sector's status as an important facet of economic management. The power sectors are natural monopolies, which create difficulties

in short-term and long-term pricing, restrict competition, and complicate, to a significant extent, their balanced and efficient development. Therefore, state management and regulation need to be maintained to improve the efficiency and reliability of power supplies. Efforts to create and operate wholesale electricity markets in Russia and other countries (Podkovalnikov, 2011) have shown that assumptions regarding the market's role as a regulator were misplaced. Many of these countries are now reconsidering their attitude towards liberalisation. This is why Russia, as expected, is continuing its market reforms, which are aimed at giving the power market a more efficient structure.

Difficulties also arise in creating a common market because the countries are employing different market models and vary in the level of liberalisation and reform they have achieved.

Although more than twenty years have passed since the collapse of the Soviet Union, the countries that emerged from former Soviet republics still face some intractable problems. These are mainly connected with their interaction in the use of natural energy resources and pricing, in particular the use of Caspian energy resources and the pricing of Russian gas and its transportation to European countries.

One of the problems associated with the common power market, and which is peculiar to Central Asia, is the need to resolve disagreements over the use of the power and water resources of trans-border rivers such as the Naryn and Vakhsh, among others. These disagreements have been caused by (a) the construction of cascades of HPPs in Tajikistan and Kyrgyzstan, (b) the requirement to provide an optimal water use schedule to all countries located downstream of the trans-border rivers in use, and (c) significant differences in seasonal water demand and energy efficiency of hydropower plants.

To overcome these disagreements, generating facilities, transmission lines (including interstate lines) and reservoirs need to be developed further and mechanisms of regional cooperation need to be created (Vinokurov et al., 2007). The EurAsEC Integration Committee is involved in efforts to resolve this problem.

There are several organisational, legal and methodological challenges which also obstruct the creation and development of the common electric power market in the CIS.

Global experience (Belyayev et al., 2008), of creating common electric power markets shows that it is a lengthy and complex process. First, countries enter into bilateral agreements on parallel operation of their national power grids. In the CIS, such agreements were made between Russia, on the one hand, and Kazakhstan, Belarus, Ukraine and Kyrgyzstan on the other. They govern relationships but do not provide a basis for free trade.

The next stage is the signing of multilateral agreements and creation of regional integrated power systems. However, in order to use these as a network infrastructure for regional power markets, the countries that are party to these agreements need to enter into special agreements to provide access to the services of their natural monopolies in the power sector and to define pricing and tariff policies. In this case this becomes possible only after the formation of the Customs Union and the Single Economic Space of Russia, Kazakhstan and Belarus. An additional requirement is the creation of a single management body to oversee long-term operation, a common market operator, and an agreed regulatory framework.

The integrated power system of the former Soviet republics actually exists, indeed the global power market recognises the Unified/Integrated Power System. However, in order to establish the common electric power market on the basis of this entity, a common regulatory framework needs to be created and approved and all the above problems resolved. This is a challenging task if the different economic interests of CIS countries and their different understanding of energy security are to be taken into account.

### RECOMMENDATIONS FOR DEEPENING INTEGRATION PROCESSES IN THE REGION

This analysis allows certain recommendations to be drawn up as to how integration can be deepened and the creation of the common electric power market and interstate IPS be speeded up in the region, with the EDB's role emphasised.

1. A comprehensive approach to integration initiatives would be effective, provided that such initiatives cover not only national power sectors and systems, but also related sectors, including production of energy resources, electrical engineering, electronics, and professional education.
2. Agreements between the EDB member states as parties to cooperation in the electrical energy sector are needed and they should be primarily multilateral, including as many participants as possible.
3. National standards in the electric power sector, electrical engineering and related sectors should be developed on the basis of a single regulatory framework, in particular the one used by the International Organisation for Standardisation (ISO).
4. Interstate electricity trading relationships should be forged based on the modified principles proposed by previous agreements regarding the formation and organisation of the common electric power market, taking into account Russia's experience of organising a competitive market.
5. The irrigation and energy disputes in Central Asia should be settled, parallel operation of the Central Asian IPS should be restored, and all its participants

should comply with dispatch requirements. The lack of understanding and cooperation in this area causes significant damage to energy and economic integration, without which further integration in Central Asia and the post-Soviet space as a whole is impossible.

6. Efforts to jointly develop the CIS power systems should give way to coordinated development of national energy sectors. Mechanisms are needed to ensure their functions are coordinated.
7. National power sectors and the interstate grid infrastructure need to be upgraded and renewed to improve the reliability of electricity supplies to consumers and electricity exchange. This would provide a solid basis for deepening energy integration between the EDB member states. EDB's participation as a source of necessary funding could be extended.

To foster integration in the electric power sectors of the EurAsEC member states and advance the creation of a common power system in the region, the following measures are essential:

- uniform methods for calculating electricity transit tariffs should be developed;
- national laws of the EurAsEC countries should be unified to support mutually beneficial cooperation in the power sector;
- regulations are needed to ensure electricity producers from the EurAsEC member states have equal access to its electricity market;
- tariff policies should be adjusted so that the majority of Central Asian power projects can go ahead even without the involvement of foreign investors;
- obsolete equipment in electrical grids and at power plants should be replaced;
- legislation is needed to make projects in the power sector more attractive to investors;
- the improvement of fuel and energy transportation infrastructure in the region should be continued;
- national power systems should apply market principles;
- key features of a unified energy policy need to be determined taking into account global trends and the need to ensure the best possible use of energy resources;
- cooperation with foreign investors should be extended in order to improve the efficiency of conventional and new energy sources;
- EurAsEC member states should adopt a professional development programme for the power sector.

## CONCLUSION

Overall, during the period under review, the electric power sectors of the EDB member states have demonstrated stable growth in generating capacity, which was maintained even in the crisis year.

Fossil-fuelled TPPs dominate the structure of generating capacity and this remained practically unchanged during the period studied. Hydropower is the main generator in Tajikistan and Kyrgyzstan. Electricity generation in these countries varies year by year because of stochastic flow of water into the plants' reservoirs.

Electricity exports and imports between the EDB member states decreased significantly and consistently over the period analysed.

The electric power sector is a driver of integration processes in related industries and sectors. Given its extensive infrastructural role for production industries and society it remains a leading sector in the EDB economies and the post-Soviet space as a whole.

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# Water and Energy Problems in the Basins of Transboundary Rivers in Central Asia and Prospects for the Development of Hydropower Resources

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Central Asia emerged as a geopolitical space encompassing Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan after the breakdown of the Soviet Union in 1991. The region occupies a vast internal drainage area in the closed Aral and Caspian basin. This explains the peculiar behaviour of rivers, which are very sensitive to the impacts of economic activities and climate

changes. The location of the region and the landlocked position of its countries require the expansion of trade and other economic ties and the deepening of integration processes. For Central Asian countries, the interstate water use and economic development of each of them depend on the specifics of regional cooperation.

The issues of water use in the basins of transboundary rivers are similar for Central Asian countries and this makes it possible to develop uniform approaches to the joint use of hydropower resources. A host of water reservoirs and irrigation, collecting and drainage canals were built in the basins of transboundary rivers. The degree of flow control in the Syrdarya basin is 1.17, meaning that the volume of water reservoirs exceeds the dependable flow, and in the Amudarya basin this ratio is 0.78.

Country	Amudarya basin				Syrdarya basin			
	Number of reservoirs	Storage capacity (million m <sup>3</sup> )		Degree of flow control	Number of reservoirs	Storage capacity (million m <sup>3</sup> )		Degree of flow control
		Gross	Active			Gross	Active	
Kazakhstan	-	-	-		21	10,075	8,867	
Kyrgyzstan	-	-	-		8	20,519	14,450	
Tajikistan	12	25,287	13,970		4	4,413	2,813	
Turkmenistan	19	7,960	7,006		-	-	-	
Uzbekistan	32	15,364	11,588		26	6,352	5,511	
Total	63	48,611	32,564	0.78	59	41,359	3,1641	1.17

**Table 12.1.**  
**Degree of flow control in the Amudarya and Syrdarya river basins**

Source: Scientific and Information Centre of the Interstate Coordination Water Commission of Central Asia (SIC ICWC)

Supporting coordinated and safe operation of reservoirs, long distance canals and large pump stations is fundamental to ensuring sustainable water use in the region. However, the situation surrounding the countries' compliance with the design and operational conditions of reservoir cascades in the basins of transboundary rivers is rather tense. The insufficient level of integration, trade and other economic relationships in the region, the lack of agreements with respect to water and energy issues, and a drastic increase in prices of fuel and foodstuffs imported from neighbouring countries are the main reasons why Central Asian countries expand their use of water resources for energy and irrigation purposes.

However, the construction of new hydropower reservoirs, flow control structures, long-distance canals and irrigation systems often violates the principles and environmental limits for the use of basins and transboundary flows, disregards the interrelationship of available water resources with their use in the short to long term and gives no importance to notifying the neighbouring states about building facilities on a transboundary river. Thus,

the change of the role of water reservoirs and other flow control structures on the transboundary rivers makes it difficult to find solutions to the problems of energy, water, food and environmental security not only for the neighbouring countries but for the region as a whole.

New hydropower and water facilities in the region are being built increasingly on a bilateral basis. As a rule, in addition to providing financing and coordination of operations at these facilities, a country that takes part in the project is provided with the right to jointly operate them upon completion for a specified period of time.

The Turkmen-Iranian Dostluk (Friendship) Dam on the transboundary Tejen River was one of the first joint projects in Central Asia. Its construction began in 2000, on parity with Iran, and was completed in 2004. The dam had a project value of \$168 million and includes a multipurpose reservoir (irrigation, electric power generation, flood control). The dam is 78 m high and its storage capacity is 1,250 million m<sup>3</sup>; the installed capacity of the hydropower plant (HPP) is 14 MW (four 3.5 MW units). The reservoir supplies irrigation water to 50,000 ha of land (25,000 ha in each of the countries). The agreement between Turkmenistan and Iran on the joint use of water resources of the Tejen (Hari Rud) River and the Dostluk (Friendship) reservoir, with each state having a share of 410 million m<sup>3</sup> of water, was signed in 2004 ([www.turkmenistan.ru](http://www.turkmenistan.ru)). In accordance with Article 8 of the Agreement, the Dostluk Dam and its facilities are jointly owned by Turkmenistan and Iran and may not be waived by any of the parties or transferred to legal entities, individuals or other countries.

**Tajikistan** has significant hydropower potential ranking eighth in the world after China, Russia, the US, Brazil, Congo, India and Canada (527 billion kWh a year, including 88 billion kWh a year ready for development). The hydropower potential of the Vakhsh and Panj Rivers accounts for 48% and 23.2% respectively, or 71.2% of Tajikistan's total hydropower resources. The bulk of the country's hydropower potential (93%) is concentrated in the basins of the Kofarnihon, Zeravshan, Bartang and Gunt Rivers, which account for 21.76% of Tajikistan's total hydropower resources. The state authorities plan to construct new HPPs in this area.

The development of Tajikistan's hydropower resources was linked primarily to the Vakhsh River, where in the 1950s the authorities commenced the construction of a cascade of hydropower plants (HPPs), including the Rogun, Nurek, Baipaza, Sangtuda-1, Sangtuda-2, and the Vakhsh Golovnaya, Perepadnaya and Central power plants.

The construction of the largest 3,000 MW Nurek HPP with nine units and a total annual generation of 11.4 billion kWh began in 1961 and was finally completed in 1979. The dam is 300 m high and the reservoir has a surface area of 98 km<sup>2</sup>. The gross and active storage capacity of the reservoir is 10.5 km<sup>3</sup> and

4.5 km<sup>3</sup> respectively. The Nurek HPP with its reservoir is a backbone facility in the Vakhsh Cascade and the Tajik power system as a whole, and plays a key role in the interstate regulation of the use of the Amudarya water resources.

All Tajikistan's large hydropower facilities were built during the Soviet era and the development of hydropower in the country has frozen since the breakdown of the USSR. Given the obsolete and worn-out equipment and grid infrastructure and decreased financing of their overhaul and upgrade, electricity generation has reduced with technical losses exceeding 2-2.7 billion kWh a year. These factors, coupled with unstable parallel operation with the electric power grids of the region, can cause shortages in electricity supplies, particularly in winter. With an increase in population, these shortages will become more acute and it is planned to commission new generating facilities to meet the growing demand.

Tajikistan's hydropower system began to revive in 2004 when agreements were signed between Russia and Tajikistan and between Iran and Tajikistan to construct Sangtuda-1 and Sangtuda-2 HPPs.

The design of Sangtuda-1 and the construction of preparatory facilities (the road and the transmission line, among others) took place simultaneously. Due to collapse of the Soviet Union, construction was halted (about 13% of work had been completed at the time). In October 2004, the governments of Russia and Tajikistan signed an agreement on the procedure and terms of Russia's participation in the construction of Sangtuda-1 and the project was restarted. In February 2005, the parties have set up a joint stock company Sangtuda-1 HPP with Russia holding an 84.03% stake in the company's charter capital and Tajikistan 15.97%. Investments by Russia and its energy companies, primarily INTER RAO UES, exceeded 16 billion roubles. The plant was commissioned on July 31, 2009.

Sangtuda-1 HPP is the largest investment project and the first hydropower facility in joint use and operation to have been implemented by Russia in the CIS. This form of cooperation in the hydropower sector is of significant interest and this experience can be used in the construction of other hydropower and water facilities by two or more countries. In this regard, it seems appropriate to discuss the construction and operation of Sangtuda-1 HPP in more detail.

The power plant is located on the Vakhsh River in Danghara District, Khatlon Province, 110 km south of Dushanbe. The fifth plant in the Vakhsh Cascade, Sangtuda-1 HPP is one of Tajikistan's largest hydropower plants, along with Nurek (3,000 MW) and Baipaza (600 MW). The plant's installed capacity makes up 670 MW (four 167.5 MW units with a service life of 25-40 years without reconstruction). It generates 2.733 TWh a year on average, including 1.64 TWh in the summer period (April-September) and 1.1 TWh in the winter period (October-March). The gross and active storage capacity of the reservoir is 258 million m<sup>3</sup> and 12 million m<sup>3</sup> respectively. Its surface area is 9.75 km<sup>2</sup>,



**Figure 12.1.**  
**Sangtuda-1 HPP**

Source: INTER RAO  
UES' archives

the flood-control storage elevation is 571.5 m, and the dead-storage elevation is 569.9 m. The rock-fill dam with clay core is 75 m high and 517 m long.

Improving the use of the economic potential of Tajikistan's hydropower resources by 3%, Sangtuda-1 HPP accounts for about 15% of overall electricity generation in the country and reduces its seasonal shortages by 30%, thereby increasing opportunities for electricity exports in the summer period. The plant was designed by the "Hydroproject Institute" named after S.Y. Zhuk and constructed by Russian and Tajik companies.

The main area of activity of the plant's operator, the Sangtuda-1 HPP company, is the generation of electricity. The structure and authority of its managing bodies are determined by the Tajik Law "On Joint Stock Companies" and the company's charter. The company's supreme managing body is the general meeting of shareholders. The procedure for preparing and holding general meetings is set forth by a respective resolution. The overall management of the company, except the issues included in the authority of the general meeting of shareholders, is vested with the board of directors. The sole executive body, which manages its day-to-day activities, is the general director. The audit committee exercises the internal control of financial and economic activities.

The price of electricity is set in accordance with the Agreement between the Governments of the Russian Federation and the Republic of Tajikistan on Cooperation in Operating Sangtuda-1 HPP dated July 30, 2009. In particular, Article 2 of the agreement states that from August 1, 2009 the Tajik party guarantees the purchase of electricity generated by Sangtuda-1 HPP for its domestic market at a price of \$0.0169 per kWh excluding VAT, for a period of 20 years. From January 1, 2010, the price for the domestic market shall increase



annually by at least 4% of the price in the previous year. In accordance with Article 3 of the agreement, in case the Tajik laws are amended so that the payback period for investments in the construction of Sangtuda-1 HPP exceeds twenty years, the Tajik party will buy electricity produced by the plant at an increased price, which is to be agreed between the company and the Tajik party and which would make it possible to have the investment paid back within twenty years of commissioning.

Electricity produced by the plant is transmitted, distributed and sold to end consumers (the population and enterprises) by Barki Tojik. Prices differ by categories of consumers. From January 1, 2010, the price of 1 kWh of electricity is \$0.0206 for the population, \$0.0487 for industrial and non-industrial consumers, and \$0.0195 for budget-funded organisations and the utilities sector.

Sangtuda-2 HPP is also a joint hydropower facility. In accordance with the Tajik-Iranian agreement on the construction of Sangtuda-2 HPP on the Vakhsh River (June 2005), Iran invested \$180 million and Tajikistan \$40 million. Iran will receive revenues from Sangtuda-2 HPP for 12.5 years from the date of the plant's commissioning. After that the ownership of the plant will be transferred to Tajikistan. The contractor for the project was Iran's Farob. Construction began in early 2006 and was completed in late 2011. The plant's installed capacity is 220 MW and generation capacity 1 billion kWh a year. It is the lowest plant in the Sangtuda power system and operates in parallel with Sangtuda-1 HPP on water released from the Nurek reservoir. The joint operation of the plants makes it possible to control the flow on a daily basis and to cover heavy winter loads.

The cooperation between Tajikistan and Iran in the sphere of hydropower is being expanded. Iran intends to take part in the construction of the 130 MW Aini HPP and is considering investing in the construction of Nurabad-1 and Nurabad-2 HPPs with a capacity of 350 MW each. The Aini, Nurabad-1 and Nurabad-2 HPPs will form a cascade on the Zeravshan River. China expressed readiness to construct Nurabad-1 HPP, but in 2009 abandoned its plans due to Uzbekistan's official position – Uzbekistan opposes the construction of hydropower plants on transboundary rivers because they could have a negative effect on the conditions of the country's water use (Troitsky, 2010).

The Rogun HPP, which is currently under construction, has the potential to become another largest hydropower facility not only for Tajikistan, but also for the region as a whole. The plant was designed by the Sredahydroproject Institute (Tashkent) and approved by the State Construction Committee of the USSR in 1974. The plant's facilities include a rock-fill dam, construction and operational tunnels, and an underground building for the power plant, which includes the turbine and transformer halls. If finished, it would be the world's tallest dam with a height of 335 m. The plant had a design capacity of



3,600 MW and an average generation of 13.1 billion kWh a year. Six 600 MW radial-flow hydropower units are to be installed in the plant. The dam is designed to form a reservoir with a gross storage capacity of 13.3 km<sup>3</sup> and an active capacity of 10.3 km<sup>3</sup> to be used for the purposes of power generation, irrigation and flow management over many years.

Preparation for construction began in 1976 and the construction of the dam (its upstream cofferdam) started in 1987. The Vakhsh River was dammed on December 27, 1987. By 1993, the level of the upstream cofferdam had reached 40 m, 21 km of tunnels had been built and the turbine and transformer rooms had been excavated to 70% and 80% respectively.

The HPP construction was suspended after the collapse of the Soviet Union and was resumed only in 2004 after Tajikistan and RUSAL (Russia) signed an agreement to continue construction. The “Hydroproject Institute” (Moscow) prepared a feasibility study and the Tajik party undertook some operations at site. However, the parties did not reach an agreement on the type and characteristics of the dam and the agreement was terminated unilaterally in 2007. Since then, Tajikistan has been constructing the Rogun HPP on its own. The damming of the Vakhsh River was planned for December 2009 but was postponed for technical and political reasons. In December 2010, operations were completed on the first construction tunnel. In 2010, Tajikistan and the World Bank formed an agreement to conduct international assessment studies for the Rogun HPP and in February 2011 Switzerland’s Poyry Energy Ltd. was selected to do this work.

The plant is scheduled to be built in several stages. The first-phase facilities are expected to have a capacity of 400 MW and an average generation of 5 billion kWh a year. The total construction cost is estimated at \$2.2 billion and the cost of the first phase at \$590 million. The first phase of construction (two hydropower units with an aggregate capacity of 400 MW) is expected to be completed in late 2012. Some hydropower equipment, including two RO310-V-483.5 turbines made by Kharkov’s Turboatom, was supplied in the early 1990s.

In accordance with the Blueprint for the Development of the Fuel and Energy Sector in the Republic of Tajikistan for 2003–2015, the main objective in this area is to ensure a balanced use of fuel, energy and water resources and stable in-country energy and fuel supplies. It is planned to develop the fuel and energy sector in stages. Its priorities in 2003–2015, which are aimed at ensuring the country’s energy security, include the construction and commissioning of a number of small hydropower plants. To this end, the state-owned Centre for the Management of Projects in the Electric Power Sector was set up to coordinate projects irrespective of the sources of finance and the Long-term Programme for the Construction of Small Hydropower Plants for 2007–2020 was approved. This programme was reviewed in view of new challenges and the Long-term

Programme for the Construction of Small Hydropower Plants for 2009-2020 was prepared on its basis.

The Programme includes three stages:

- a short-term stage (2009-2011): 66 plants with a total installed capacity of 43.53 MW and an estimated cost of \$51.593 million;
- a medium-term stage (2012-2015): 70 plants with a total installed capacity of 32.85 MW and an estimated cost of \$39.38 million; and
- a long-term stage (2016-2020): 53 plants with a total installed capacity of 26.801 MW and an estimated cost of \$32.161 million.

The Programme is expected to be financed by local and foreign investors. Industrial enterprises are provided with certain preferences if they build their own small hydropower plants. Electricity produced by these plants will be cheaper than that purchased from the power system. The price of electricity produced by a small power plant, which is owned by an enterprise, will not exceed its prime cost. The experience of constructing small plants in Tajikistan has shown that the cost of construction does not exceed \$1,100-\$1,200 per kW.

The investment needed for all three stages of the programme exceeds \$123 million and is being sought from international financial institutions. The Islamic Development Bank (IsDB), the Asian Development Bank (ADB), the International Finance Corporation (IFC), UNDP, and Iran are financing the construction of 23 small hydropower plants in Tajikistan.

**Kyrgyzstan** has also developed and is implementing a programme to construct new large and small hydropower plants, which lists Kambarata-1 and Kambarata-2 HPPs as priorities.

The prospective trade in electricity envisioned by Kyrgyzstan and Tajikistan targets primarily South Asian countries. In 2006 the CASAREM (Central Asia/South Asia Regional Electricity Market) programme was launched with assistance from the ADB to develop the sub-regional electricity market. The CASA-1000 (Central Asia/South Asia) project was launched in the framework of the programme, providing for the export to South Asia of electricity produced in summer by Tajikistan's and Kyrgyzstan's active hydropower plants. CASA-1000 creates a system to transmit electricity from Kyrgyzstan and Tajikistan to Afghanistan and Pakistan, which will make it possible to export up to 1,000 MW during the first phase with subsequent increase in supplies. The participants in the CASA-1000 project and the CASAREM programme are Afghanistan, Kyrgyzstan, Pakistan and Tajikistan. The total expenditures, including contingencies and interest for the period of construction, reach \$953 million. They include the improvement of domestic transmission grids for the CASA project and preliminary environmental and social costs.

Each country is expected to provide financing for the facilities that are located in its territory and involved in the project. Thus, Afghanistan will provide \$309 million, Kyrgyzstan \$196 million, Pakistan \$197 million and Tajikistan \$251 million.

CASA-1000's main objective is to build transmission line interconnections. The proposed facilities include a 477 km 500 kV Datka-Khujand transmission line to connect the power grids of Kyrgyzstan and Tajikistan; a 350 km 500 kV Khujand-Rogun-Sangtuda line to connect Kyrgyzstan and Northern Tajikistan with Tajikistan's central regions; a 750 km 500 kV Sangtuda-Kunduz-Puli Khumri-Kabul-Peshawar line from Tajikistan through Pakistan to Afghanistan; and substations in Datka, Khujand, Sangtuda, Kabul and Peshawar.

Within the framework of the CASAREM programme the 500 kV South-North transmission line was commissioned in Tajikistan, the 220 kV Tajikistan-Afghanistan line is currently under construction and a 500 kV Datka-Kemin-Almaty line is being planned to link Kyrgyzstan and Kazakhstan.

The regional project to construct the 220 kV Sangtuda-Puli Khumri transmission line interconnection (Tajikistan-Afghanistan) includes the construction of a 118 km Tajik section from Sangtuda-1 HPP to the state border and a 156 km Afghan section. Construction has been completed in Tajikistan and is on-going in Afghanistan.

The 410 km 500 kV Datka-Kemin transmission line is scheduled for completion in 2012-2013. Kazakhstan plans to build a 500 kV Almaty-Kemin line (Kazakhstan-Kyrgyzstan).

**Uzbekistan** also plans to build a number of small and medium hydropower plants with an overall capacity of 937.6 MW in the medium term in order to increase the share of hydropower resources in its fuel and energy balance.

The Uzbek Ministry of Agriculture and Water Management is implementing a programme to build hydropower plants at the existing water reservoirs. The Akhangara HPP (42 MW) was commissioned in Tashkent Province, the Gissarak HPP (45 MW) in Qashqadarya Province, the Shakhimardan HPP (2.2 MW) on the Koksui River in Ferghana Province, and the Gulistan HPP (6 MW) in Samarkand Province. When the second phase of the Tupolung HPP construction on the Surxondaryo River is completed, its total capacity will reach 175 MW. The aggregate capacity of hydropower plants controlled by the ministry exceeds 439 MW.

Four new plants are scheduled to be commissioned in Tashkent Province before 2015: the Lower Chatkal HPP on the Chatkal River (with a capacity of 100 MW and a cost of \$105.5 million), the Akbulak HPP on the Akbulak River (60 MW and \$62.8 million), the Kamchik HPP on the Akhangaran River (30 MW and \$34.5 million), and the Irgailik-Sai HPP on the Ugam River (13.6 MW and \$25

million). It is also planned to construct the Pskem HPP and the Mullalak HPP on the Pskem River with a capacity of 404 MW and 240 MW respectively. In Surchondarya Province, the construction of the Nilo-2 HPP (30 MW and \$33.3 million) on the Sangardakdarya River and the Zar-Chob HPP (90 MW) on the Tupalangdarya River is planned.

Overall, 44 investment projects for a total of \$5.27 billion are planned to be implemented in the power sector of Uzbekistan in 2011-2015 (RU, 2011b). In addition, Uzbekistan is building new large water reservoirs (Kenkul-Sai, Zhiidali and Rezaksai). In 2008, the Chartak water reservoir was completed in Namangan Province. A loan from China was raised for the construction of the Rezaksai reservoir with the estimated cost of \$46 million.

The energy sectors of Central Asian countries are connected with water management and, ultimately, agriculture and this should be taken into account in ensuring their operation. A strive for independent energy and water policies in Central Asia results in reduced interstate power flows in the region and poorer coordination of the power systems. The power systems become isolated in a gradual fashion, hence their worsened coordination and reduced efficiency of the Central Asian integrated power system, which cannot ensure their reliable operation. The countries' power grids need an urgent overhaul and modernisation of active plants, as well as technological reconstruction of the existing infrastructure. The diversion of funds solely to projects that are expected to pay back in the long term does not foster economic growth in the countries concerned. In addition, the lack of synchronisation in the use of water reservoirs between power generation and irrigation does not promote energy and water security in the region, interstate cooperation, and integration processes.

Experts believe that this scenario will have significant negative consequences for all countries in the region. When the operation of hydropower plants is not balanced by irrigation and environmental needs, carry-over storage reservoirs lose their compensatory capacity during periods of draught and low water, hence a threat to food and energy security in the region. The supplies of electricity outside the region should be synchronised with the interstate water use. Otherwise, electricity exports to external markets, i.e., outside the closed water basin (region) with limited water resources, may have a negative effect on interstate relationships and energy, water, food and environmental security in Central Asia.

Mark Lvovich, a known Soviet hydrologist, wrote that the efficient control of water resources and cooperation in this area are necessary for the resolution of regional water and energy problems. He said that, "[...] different water levels in different years affect the economy in an unfavourable manner. For this reason, one should not underestimate the significance of the long-term control of river flows, especially in Central Asia whose primary agricultural sector, irrigated

farming, is seriously damaged by dry periods. The key to improving the efficiency of the use of water resources in Central Asia is the long-term control of river flows with the help of a system of water reservoirs, which should be built in the mountains where water resources form. The existing water reservoirs and those under construction have significant storage capacities but it should be borne in mind that they operate to HPPs' schedules and do not fully meet the needs of irrigated farming and water supply; moreover, their work often contradicts these objectives. The issue of priorities in the use of water resources is of regional importance. In ensuring water supplies, the quality of water is a significantly more acute challenge, especially downstream where considerable volumes of river flows consist of mineralised, irrigation return water. In the case of electricity generation, this area of water management at irrigation water reservoirs can be concurrent and rather efficient during approximately half of the time of their operation. However, the damage caused to hydropower generation can be compensated by thermal power plants or by the construction of hydropower plants in other regions, primarily where significant volumes of water are not needed for irrigation. Hydrological forecasts also play an increasingly important role given the need to plan the operation of carry-over storage reservoirs. Reliable long-term forecasts result in cubic kilometres of additional water for irrigated farming as they allow the allocation of the greatest possible volumes of water for irrigation from water reservoirs with minimal storage capacity” (Lvovich, Tsigelnaya, 1979: 124-135).

Kazakhstan, Uzbekistan and Turkmenistan boast significant raw material resources (Tajikistan and Kyrgyzstan are more limited in this regard), including oil, gas, gold and other minerals. All of these countries have a rather developed infrastructure and labour resources and each has potential to fulfil its planned social projects. Global prices of minerals and energy resources in particular also contribute to the economic development of the countries and their economic integration in the power sector. International practice shows that regional power sectors are more sustainable when power systems work in parallel. This mode of operation makes it possible to optimise generating capacities and improve the efficiency of heat generation.

Another advantage of parallel operation in the Central Asian integrated power system is the possibility to redistribute demand and optimise it by regional time zones. In the longer term, this will make it possible to ensure a wider use of renewable sources of energy for additional generation. The renewal of synchronised operation of Central Asian power grids is needed to ensure their economic and technological efficiency. The overall economic effect from renewed parallel operation in the region, compared to the isolated mode, could reach \$1.6-\$2.1 billion in the first three years. On the whole, the advantages of the integrated power system are far more significant than its possible drawbacks. The integrated power system will be of benefit to all its participants, both technologically and economically (WB, 2010).

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# Chronicle of Eurasian Regional Integration 2011

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Natalia  
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Despite all the gloomy predictions, the CIS integration associations are gaining strength thanks to the efforts of its members. Eight CIS countries signed the Free Trade Area Agreement, paving the way for more advanced forms of integration based on CIS foundations. Moreover, the CIS countries are negotiating agreements on regulating mutual access to national currency markets for the CIS resident banks and on key principles of currency regulation and control in the CIS member states. Observers have commented on Ukraine's increased participation in the CIS integration processes in 2011. Regional cooperation in transport is progressing, and all eleven CIS countries have introduced unified technical standards, rules for exchanging rail cars, and a common tariff policy.

On July 1, 2011 the Customs Union became fully operational and customs controls were duly transferred from the borders between participating countries to the CU's external border. Since July, there has been a significant reduction in the number of preferential duty rates for certain goods applicable in Kazakhstan. These preferential arrangements had been implemented to protect Kazakhstan's markets from competing goods, and therefore their existence had hindered the full-scale launch of the CU. Discussions are now under way on unifying passport and visa controls in the CU member states. The CU Commission has approved a draft agreement on transporting goods by pipelines and power lines across

the customs border. The ratios for redistributing import duties between the CU states may be adjusted in favour of Belarus and Kazakhstan. Problems with VAT calculations (because the rates of this tax differ), the absence of unified technical regulations and different customs requirements specified in CU member-state legislation, are all added burdens for entrepreneurs. Moreover, concerns have been raised over the rate at which Russian businesses are moving into Kazakhstan to take advantage of lower taxes.

In April 2011 the government of Kyrgyzstan approved the country's accession to the CU and the Single Economic Space of Belarus, Kazakhstan and Russia. Tajikistan also intends to join the CU. Discussions are continuing in Ukraine about the potential benefits for the country of joining the CU.

The Single Economic Space has become an economic reality. The Presidents of Russia, Kazakhstan and Belarus signed the Declaration on Eurasian Economic Integration, the Agreement establishing the Eurasian Economic Commission (EEC, the Customs Union's supreme body) and its procedural rules, and the Agreement on the Single Economic Space. Thanks to this preparatory work in 2011, on January 1, 2012, the SES between Russia, Kazakhstan and Belarus will start functioning, replacing the CU. The systematisation of its legal framework is now a priority, with the codification of documents being the first step towards this goal. To date, there are 104 documents, which together constitute the unified regulations of the CU and the SES; some of these were signed in the mid-1990s. The parties have decided to amalgamate them into a single document similar to the Treaty of Rome. Should Russia, Belarus and Kazakhstan succeed in harmonising their legislation by 2015, the countries will unite in the Eurasian Economic Union.

Russia's accession to the WTO has been a matter of extreme importance, not only in the last year. Russia now faces a large-scale revision of its protectionist foreign trade practices and a struggle against barriers to Russian exports. In addition, around one-third of the tariff rates introduced under the Russian Federation's WTO commitments are higher than those applied within the CU, so Russia, Kazakhstan and Belarus will have to decide what rates should be applied.

Last year Belarus faced the official devaluation of its national currency. The one-off devaluation of the Belarusian rouble on May 24, 2011 reduced the value of the currency by 53%, or by over 70% compared to its quoted value in January 2011. The sharp devaluation of the currency led to an economic recession in the country, accompanied by, inter alia, a temporary suspension of electricity supplies to Belarus from Russia and Ukraine. A loan agreement with the EurAsEC Anti-Crisis Fund (ACF) has mitigated tension in the Belarusian foreign exchange market. In mid-June, the Eurasian Development Bank transferred to Belarus the first \$800 million tranche of the \$3 billion loan from the EurAsEC Anti-Crisis Fund.



There was also some integration in the oil and gas sector in 2011. Kazakhstan's KazMunayGas National Oil Company (KMG) expressed an interest in joint projects in Russia with OJSC Gazprom Neft. Ukraine's Naftogaz discussed possible joint ventures with TNK-BP and LUKOIL on the Black and Azov Sea shelves.

Nevertheless, 2011 did not see an end to conflict over the terms of Russian energy supplies. The latest in a series of interruptions in Russian oil supplies to Belarus took place in early 2011 and was only resolved by the signing of new contracts with Russian oil companies.

Despite the early success of integration in the context of the CU, bilateral relations between some of the former Soviet countries deteriorated considerably during the year, most notably affecting relations between Russia and Ukraine. Last year saw the signing of a landmark agreement between Moscow and Kyiv, but in the middle of 2011 the President of Ukraine, Viktor Yanukovich, asked for Russian gas prices to be revised, effectively bringing Kyiv into open conflict with Moscow. The dispute is yet to be resolved: Gazprom says it has no intention of lowering its prices, while Kyiv is refusing to negotiate on Ukraine entering the CU and placing its gas transportation system under Russian control. Because of the price advantage of imported oil products over the output from Ukraine's own refineries, Russia's LUKOIL and TNK-BP have idled their refining capacity in Ukraine. Russia has also faced problems in trying to develop cooperation in nuclear energy with Belarus and Ukraine.

Integration initiatives in other sectors included the establishment of a joint venture between Russia and Kazakhstan in grain transportation and Russia's entry into Kazakhstan's terminal operations and freight-handling market, which may eventually lead to a unified freight railway infrastructure. Kazakhstan and Russia's RUSAL agreed to create a joint venture to manufacture railcars, while another joint venture plans to produce UAZ automobiles in the Kazakh city of Kostanay. Kazakhstan and Russia ratified an agreement to build a third power unit at the Ekibastuz GRES-2, the other two units of which currently account for 12% of all electricity generated in Kazakhstan. As for the financial and banking sector, VTB Kazakhstan, a subsidiary of Russia's state-owned VTB Bank, became a member of Kazakhstan Stock Exchange (KASE) currency market, paving way for further financial integration.

The year ended with the adoption of measures to facilitate the Collective Security Treaty Organisation's (CSTO) transition to a fully-fledged military and political bloc, whose members must take each other's, as well as their own, interests into account. From now on, no foreign military facilities can be deployed in any of the CSTO countries without the sanction of all CSTO member states. These changes have also affected the function of the Collective Rapid Reaction Force (CRRF), which may now be deployed to protect the constitution in any of the CSTO member states.

Ukraine has participated actively in military and political cooperation. The Russian Defence Ministry announced plans to purchase Russian-Ukrainian AN-70 aircraft, Ukraine stated its intention to join in with Russian-Belarusian Union Shield-2011 large-scale drills, and Russia and Ukraine negotiated the controversial issue of the Black Sea Fleet stationed in Crimea.

## REGIONAL ORGANISATIONS

### CIS

#### **CIS Economic Court to settle Customs Union disputes**

*January 18, 2011*

Disputes within the Customs Union of Belarus, Russia and Kazakhstan are to be settled by the Economic Court of the Commonwealth of Independent States. The protocol amending the agreement between the CIS and the Eurasian Economic Community (EurAsEC), which transfers the functions of the EurAsEC Court to the CIS Economic Court, was signed in Moscow on January 17, 2011.

Under this agreement, the Court will oversee compliance of CU documents with the international agreements governing the CU, and will interpret international agreements and official Customs Union documents. The CIS Economic Court will settle disputes between the Customs Union Commission and its member states.

The agreement also states that other disputes, which must be resolved according to international agreements applicable to EurAsEC and the CU, will also come into the remit of the CIS Economic Court.

The document was signed by the Chairman of the CIS Economic Court Fayzullo Abdullayev and EurAsEC Secretary General Tair Mansurov.

*CIS Executive Committee Press Service,  
IA Novosti-Kazakhstan*

#### **CIS Economic Council Approves Free Trade Area Draft Agreement**

*April 15, 2011*

The CIS Economic Council approved a draft Agreement on a Free Trade Area that would bring the goal of liberalised trade a step closer for most of the former Soviet republics. CIS heads of government are meeting to discuss the document in May 2011 in Minsk.

The Free Trade Area Agreement is due to replace the current system that exists between CIS member states and is expected to decrease the number of goods that are subject to import duties.

May 19, 2011

The CIS Heads of Governments Council requested a revision of the draft Free Trade Area Agreement because a number of its provisions needed to be harmonised.

**Note:**

*The Free Trade Area Agreement was originally drafted by the Ministry of Economic Development of Russian Federation in 2008. The CIS member states' amendments to the agreement were drafted by the special working group and completed by February 2011. The Economic Commission of the CIS Economic Council approved the amended draft of the agreement in March.*

*Ukraine's Foreign Minister, Konstantin Gryshchenko, stated in April that Ukraine had been active in improving the document and would sign the agreement on the CIS Free Trade Area in the near future.*

RIA Novosti

**Marchenko: creation of CIS supranational currency is possible  
within 8-10 years**

October 18, 2011

The chairman of the National Bank of the Republic of Kazakhstan, Grigory Marchenko, believes that it may be possible to establish a single supranational currency in the CIS within the next 8-10 years, if there is concerted action on this from all countries in the region.

Marchenko believes that the world should have multiple reserve currencies, but that it will take time for the predominance of the dollar as the currency of choice for international transactions to wane. For the rouble to attain the status of reserve currency, Russian companies should use the Russian rouble for their own settlements. Marchenko said one of the impediments in positioning the rouble as a reserve currency was Gazprom's reluctance to accept rouble payments from Moldova and Ukraine for 15 years. Marchenko noted the situation had changed, but not sufficiently.

The creation of a supranational currency within the Single Economic Space (Russia, Kazakhstan, Belarus) is still in the planning phase. According to Marchenko, following the EU example was the best way forward; participants should agree on the macroeconomic parameters that should be observed, without exception, and harmonise fiscal policy, as had been achieved in Europe.

The lack of a unified fiscal policy was reflected in the volatility of the rouble against the dollar in recent years, with fluctuations of up to 20% in Russia and 2% in Kazakhstan.

It was also necessary, he said, to learn from the EU's mistakes, and try to do better.

*Finam.ru*

### **CIS Heads of Government sign Free Trade Area Agreement**

*October 18, 2011*

Eight CIS Prime Ministers signed the Free Trade Area Agreement in St. Petersburg. Azerbaijan, Uzbekistan and Turkmenistan have declined for the time being. They will consider joining the treaty by the end of 2011.

In 1994, the CIS countries had signed a similar free trade area agreement; however it was never implemented because the parties were unable to secure unanimous ratification due to discrepancies that have mostly been eliminated this time around. The agreement may reconfigure trade and economic ties in the post-soviet space.

According to Russian Prime Minister, Vladimir Putin, the free trade agreement is another step towards the successful integration of neighbouring states, which is essential to boosting trade and economic growth.

Putin noted that trade turnover between the CIS countries increased by around 50% in January-June 2011, exceeding \$134 billion and almost reaching the pre-crisis level.

The agreement will abolish export and import duties on several groups of commodities; however, the restrictions on free trade in gas, oil and sugar will remain.

In addition, the CIS heads of governments signed a further 28 documents, including an agreement on currency regulation and control in the CIS member states, and a draft plan for rail transport in the CIS to 2020.

*Expert*

### **EurAsEC, CSTO and CIS coordinate their activities to regulate migration, strengthen international security and improve response to emergencies**

*November 22, 2011*

Moscow hosted a meeting of top EurAsEC, CSTO and CIS officials to improve how the three organisations' Secretariats operate with regard to strengthening integration between the member states.

The organisations' executive agencies discussed the implementation of migration policy, and the legal basis for international cooperation to regulate the migration process. Delegates at the meeting were briefed on the most important issues identified in the field of migration, and heard proposals to boost the efficiency of the EurAsEC, CSTO and CIS agencies working together on projects.

In addition, participants reviewed approaches to international security and stability, and new challenges and threats emerging in 2012-2013. Interaction in the wake of natural disasters or man-made emergencies was also high on the agenda for discussion.

*CIS Executive Committee*

## **EurAsEC**

### **Customs Union**

#### **Distribution of customs duties within Customs Union may benefit Belarus and Kazakhstan**

*February 25, 2011*

According to the head of the Russian Federal Customs Service (FCS), Andrei Belyaninov, the redistribution of import customs duties between the CU states may favour Belarus and Kazakhstan. Belyaninov drew attention to errors of calculation, and said "the numbers speak in favour of Belarus and Kazakhstan". From a practical point of view, the receipt and redistribution of customs payments did not cause concern. According to Belyaninov, the adjusted coefficients have been defined; however the Ministry of Finance of Russia still needs to make a decision.

#### **Note:**

*The procedure for receiving and redistributing customs duties came into effect on September 1, 2010. According to the trilateral agreements between the CU member states, import duties are transferred to a shared account and then distributed on a pro-rata basis between the CU member states with 87.97% of the total import duties going to Russia, 7.33% to Kazakhstan and 4.7% to Belarus.*

*RIA Novosti, IA Novosti-Kazakhstan*

#### **Customs Union and Ukraine discuss accession**

*March 16, 2011*

Summarising the meeting of the EurAsEC Interstate Council, Russian Prime Minister Vladimir Putin noted that Ukraine's accession to the Customs Union or the Single Economic Space would "enrich the integration processes". According to Putin, Ukraine's participation in the CU would "increase the country's benefits" in international negotiations.

Russia is somewhat concerned by Ukraine's plans to establish a free trade area with the EU. As Putin noted, "Russia will be forced to close the customs border with Ukraine if the country creates a free trade area with the EU, and sensitive items will be delivered to the Russian market bypassing the established level of tariff protection". The tariff levels set by Ukraine during negotiations with the

EU are less than half the existing customs tariff in Russia. Russia also plans to establish a free trade area with the EU in future. Ukraine has not yet announced any restrictions on trade with Russia it may consider if this comes to fruition.

On June 6, 2011 Ukrainian President Viktor Yanukovich established a special working group on boosting cooperation with the Customs Union of Russia, Belarus and Kazakhstan. Within two months the working group will draft a strategy of interaction between the CU and Ukraine on a 3+1 basis. Ukraine plans to sign a free trade area agreement with the EU by the end of 2011. Russia invited Ukraine to join the CU, and Kyiv expressed its readiness to cooperate with the CU, but only on a 3+1 basis.

*Kommersant-Online, Kursiv.kz*

### **Belarus streamlines border controls with Russia**

*April 1, 2011*

Transport checks on the Belarusian-Russian border ceased from April 1, allowing cars to cross the border without stopping and without the need for special documents. From now on transport control will be performed only at the external border of the Union State. More than half of the 11 transport checkpoints have been shut down and the five remaining points are equipped only with weighing systems.

Russia and Belarus have agreed that Belarusian specialists will check carriers' special permits for entry into Russia, for transportation of dangerous goods and for heavy-duty and large vehicles, in accordance with Russian standards.

The decision to eliminate transport controls between the two countries was taken during a meeting of the Customs Union Commission on March 14, 2011.

Kazakhstan and Russia have also agreed to transfer all transport checks to the external border of the CU by July 1, 2011.

*Expert Online, top.rbc.ru*

### **Kyrgyz Government welcomes country's accession to Customs Union**

*April 11, 2011*

The government of Kyrgyzstan decided to launch the process of accession to the CU and the SES of Belarus, Kazakhstan and Russia. On April 11, the government set up a commission to negotiate the accession process taking into account Kyrgyzstan's sensitive products and economic sectors. Meeting delegates noted that integration with countries of the Eurasian Economic Community was a priority for Kyrgyzstan. Belarus, Kazakhstan and Russia reportedly account for 44.9% of Kyrgyzstan's foreign trade. The Kyrgyz government is to file a membership application with the EurAsEC Interstate Council.

*October 17, 2011*

According to the acting Prime Minister of Kyrgyzstan, Omurbek Babanov, his country would not be ready to join the Customs Union of Russia, Belarus and Kazakhstan by early 2012. The government filed a membership application and established a working group to discuss the details of Kyrgyzstan's accession with "the working group that should have been established for this purpose by the CU", Babanov said. The working groups have many issues to discuss as a priority, including any grace period granted to Kyrgyzstan's certain economic sectors as it enters the CU.

*November 23, 2011*

The Executive Secretary of the Customs Union Commission, Sergei Glazyev, noted that all the necessary technical work on the Kyrgyzstan's accession to the CU could be completed within the next year. According to Glazyev, the legal systems of Kyrgyzstan and the CU were similar enough to ensure the process would not be prolonged. Technical equipment at Kyrgyzstan's border checkpoints and information exchange are currently two of the major problems.

Kyrgyzstan's accession to the CU will boost the development of the country's agribusiness and energy system, which could become part of the common energy market, allowing for the construction of new hydropower plants and the development of associated industries, Glazyev said, adding that Kyrgyzstan's accession to the CU would encourage growth of the republic's economic potential by at least 20-25%, and boost its attractiveness to investors.

*www.tsouz.ru, Expert Online*

### **Customs control between Customs Union member states to be eliminated from July 1**

*May 20, 2011*

Kazakhstan assured Russia and Belarus that it will protect both states from goods being imported cheaply into Kazakhstan. Therefore, customs control between the three states will be abolished from July 1, 2011.

Russia's Federal Customs Service drafted a presidential decree on the transfer of controls on the Russian-Belarusian and Russian-Kazakh borders to the external border of the CU starting July 1, and on the dissolution of 16 customs organisations.

Border transfer will eliminate customs controls between Russia, Kazakhstan and Belarus, as foreseen in the Customs Union founding documents. Customs clearance within the CU was abolished in July 2010, though the countries agreed several temporary exclusions from the common customs territory, the

majority of which will be valid until 2015. Kazakhstan may lower customs duty rates on over 400 goods, including cars, sugar, medicines, plastics, paper, aluminium goods and electronics. Belarus too will pay reduced car import duties. However, an additional fee is applied to these goods as they cross the Russian border to balance the total payment to the common tariff.

*Vedomosti*

### **Customs Union states unify rail tariffs**

*May 23, 2011*

In mid May Kazakhstan's Majilis (the Lower Chamber of Kazakhstan's Parliament) ratified the agreement on regulating access to rail transport services, including pricing policies. The agreement had been signed by Russia, Belarus and Kazakhstan in December 2010. It foresees the use of one unified tariff instead of three – export, import and intrastate – from January 1, 2013. The tariffs will be determined in accordance with the national legislation of each country with potential differentials based on the nature of freight, type of cars, distance and railcar loading level.

The essence of unification is that the parties voluntarily waive protectionist practices in the field of rail transport; however, each country defines its own unified tariff to protect national interests and reduce the tariff burden on domestic consignors. For instance, if a Kazakh entrepreneur plans to work with OJSC Russian Railways (RZD), he will be offered the same conditions that are offered to Russian businessmen, from provision of rolling stock to the tariff level.

Tariff unification would reduce the cost of freight transport for many but not all businesses. Thus, for example, Russian mineral fertilizer producers, Silvinit and Uralkali, may find their transport costs increase under the unified tariff, because rebates for certain export routes will be abolished, affecting return journeys of empty railcars. According to experts, tariff unification bears potential risk for Kazakhstan, since the main flow of commodities is from Russia to Kazakhstan but not vice versa.

Nevertheless, tariff unification brings great potential benefits. Among other things, it will guarantee equal access to infrastructure as a step towards securing equal conditions for all carriers from January 1, 2015. Regulations on equal access to infrastructure will be drafted by January 1, 2013.

*Expert Kazakhstan*

### **Kazakhstan in the Customs Union**

*May 23, 2011*

From January 1, 2010 Russia, Kazakhstan and Belarus have operated a unified customs policy regulated by eight international agreements, a unified customs



tariff and a shared list of goods subject to the same non-tariff rates. The CU member states turned their attention to harmonising trade regimes with CIS countries and special protective and antidumping measures in the CU. A protocol on exemptions came into force along with the Customs Code. The protocol retains customs clearance procedures for "transition period" goods and commodities that are not subject to unified terms of trade, and protective and antidumping measures. In particular, Kazakhstan has negotiated a preferential tariff for cars imported by private individuals, valid till July 1, 2010. Special terms for other imported items remain valid for longer. For instance, Kazakhstan's sugar refineries have been granted the right to import raw cane sugar duty-free for 10 years, and Belarusian and Kazakh airlines are exempt from import duties on aircraft till July 1, 2014. The duty-free import of aircraft spare parts has no time limit. In addition, Kazakhstan has negotiated a preferential tariff for imports of medicines, medical equipment, railcars, greenhouses, and raw materials for the light industry, chemical, and woodworking industries until 2014.

According to Zhanar Aitzhanova, Minister of Economic Integration of Kazakhstan, since the introduction of the CU in 2010 Kazakhstan's foreign trade has increased by 26% due to price increases for Kazakhstan's exported oil and metals. The structure of exports and imports has not changed in qualitative terms. The CU member states, the EU and China remain Kazakhstan's major trading partners.

Russian direct investment in Kazakhstan's economy has increased by 0.5% since the introduction of the CU and 400 Russian enterprises are now registered in Kazakhstan, Aitzhanova said.

*Expert Kazakhstan*

### **Customs Union abolishes border control**

*July 1, 2011*

From July 1, the CU begins to operate fully with customs controls being entirely transferred to the external borders of the Union. Russian customs officers will have observer status on the Belarusian-Russian and Kazakh-Russian borders. Border guards will remain at the Kazakh border while migration and other types of legislation are harmonised.

Control over certain types of goods imported from Kazakhstan will be retained on a temporary basis: from July 1 Kazakhstan introduces import duties on the majority of goods in line with the common customs tariff, with exemptions on 88 items (mostly medicines and medical equipment).

In future the CU member states will enter into shared trade regimes with other countries. The CU has begun negotiating free trade agreements with the European Free Trade Association (EFTA) and New Zealand, and has established

working groups to study the feasibility of similar agreements with Syria, Vietnam, Mongolia and Egypt. The establishment of a Single Economic Space from January 1, 2012 will be the next step towards integration. It is expected that the Customs Union Commission will be granted more authority to enable it to be more effective. From January 1, 2012 the Customs Union Commission is invested with 90 new powers relating to tariffs, subsidies, foreign trade and competition policy.

*RBK Daily*

### **No work permits for migrant workers from Russia, Belarus and Kazakhstan**

*July 4, 2011*

Russia's State Duma ratified an agreement on the legal status of migrant workers from the CU member states, which streamlines the bureaucracy involved in staying and working in Russia, Belarus and Kazakhstan. Under the new agreement, migrant workers do not need work permits to work legally within the CU member states. Moreover, migrant workers from Russia, Belarus and Kazakhstan and their family members have 30 days after entering the country to register with the competent authorities there. The length of their stay will depend on the duration of the work contract. Should the employment contract be terminated migrant workers will have 15 days to find another job. However, migrant workers are prohibited from working in strategically important economic sectors, public order and healthcare services.

These agreements represent the CU member states' efforts to ease the movement of manufacturing resources, including labour.

*Expert Kazakhstan*

### **Bar code tracking introduced in grain market**

*July 6, 2011*

Experts drafting technical legislation "On Safety of Grain" in the CU have proposed a system for monitoring grain as it moves from the field to end consumer. The Russian Ministry of Economic Development reports that a system of assigning a bar code to every grain market participant is being considered. Starting July 5, the Ministry began negotiations on this proposal, with Kazakhstan being responsible for the relevant draft technical regulations. The draft will be based on similar technical regulations adopted by the EurAsEC, with a new section on ensuring grain traceability. The added section stipulates that unsafe grain should be withdrawn from circulation immediately and its origins traced, which would be possible as long as all participants in the grain market (at every stage of the supply chain) have registered with their relevant CU authority and received from them a special identification number (bar code). The bar code will carry information, such as where the grain was produced, the

field number, crop code, the address of the transport company that moved it, and the grain depot or store. Individual numbers have to be assigned to every producer, transporter, warehouseman and individual or legal entity engaged in grain transactions. Together with the bar code each grain market participant will receive a document confirming the name and address of the participant, their type of activity and coordinates of the local supervisory authority. The draft technical regulation is scheduled to be enacted on July 1, 2012, according to an explanatory note.

*Kommersant*

### **Customs Union member states to create special ministry**

*September 16, 2011*

Russia, Belarus and Kazakhstan intend to establish a special CU ministry responsible for ratifying ordinary and strategic decisions and approving draft international agreements. Viktor Khrystenko will be appointed head of the ministry. The draft agreement on the Customs Union Commission will be reviewed during the Commission's regular meeting on September 22-23 in Almaty. If the agreement is ratified, the current management structure – via the supervising Deputy Prime Ministers – will be superseded by a two-tier management structure consisting of the Commission Council (a ten-member strategic body) and the Commission Board, which would become a separate supranational government operating on a professional, rather than a national level.

A chairman will be appointed from among the ministers or commissioners on the Board. It is assumed that the Deputy Prime Ministers of Belarus, Kazakhstan and Russia will become members of the Commission Council (currently these are Sergey Rumas in Belarus, Umirzak Shukeev in Kazakhstan and Igor Shuvalov in Russia). Russia will receive 57% of votes in the Council, Belarus and Kazakhstan – 21.5% each. The countries will take turns in presiding over the Council. The Commission's decisions will become legislation, which, along with international agreements, will constitute the contractual and legal framework of the Single Economic Space. The Commission's operations will be financed by contributions from the parties proportional to their number of votes. According to preliminary estimates, the budget may amount to \$50-\$60 million. The Commission will be based in Moscow.

*Vedomosti, Kursiv.kz*

### **Controversies over Customs Union technical regulations**

*October 3, 2011*

The CU has been functioning for almost two years since January 1, 2010. Borders are open and goods move freely between Kazakhstan, Russia and

Belarus according to unified rules. However, while a *de jure* customs union is in place, *de facto* there are still several issues to be resolved. The CU agreement on technical regulation was signed in November 2010, yet Kazakhstan, Russia and Belarus have not yet established unified technical regulation and control, and have not adopted common technical regulations.

The members speeded up their work drafting common technical regulations, and granted 46 drafts top-priority status for 2011. Of these 46, eight were drafted by Belarus, 13 by Kazakhstan and 25 by Russia.

A unified quality mark will be introduced for goods entering the markets in the three member countries. During the transition period, manufacturers will have the right to choose from a list of goods which are subject to mandatory conformity evaluation confirmed by documentation recognised in all three countries. "Transit" certificates, or declarations of conformity that are recognised in all the CU member states, are already available for products that are not included in the list (over 200 items). The list of goods is constantly growing.

Consensus is vital for the ratification of CU technical regulations. However, disagreements do arise in the negotiations between the CU member states. For instance, Kazakhstan refused to discuss the draft technical regulations on tobacco products agreed by Russia and Belarus. The decision to ban the collection and recycling of glass containers that have contained alcohol and infant food from July 2012 has also led to disputes. In some instances, European norms are used as the benchmark, to help the parties to reach consensus. The majority of CU technical regulations are based on the national technical regulations of Russia that were harmonised with EU directives.

*Expert Kazakhstan*

### **Businessmen assess first results of Customs Union**

*October 17, 2011*

Businessmen have given their initial assessment of the effects of the Customs Union of Russia, Belarus and Kazakhstan.

Research carried out jointly by RBK Daily and Kelly Services recruitment agency suggests that businesses are facing longer queues at the customs, excessive bureaucracy, and a backlog of tax legislation. According to a survey carried out among Russian transport and logistics companies, 69% of respondents believe that the CU has simplified their dealings with Belarus and Kazakhstan, and 54% of respondents claim that the law "On Customs Regulation" that replaced the Customs Code in November last year has had a positive impact on their operations.

Problems with VAT calculations (the difference in tax rates), the failure to unify technical regulations thus far and different customs requirements are

problems for entrepreneurs. Currently each state may establish different rules and regulations on such matters. Nevertheless, a complex legal system is the root of all problems because at present the CU legislation has not been codified – simultaneously there exist the Customs Code and numerous decisions by the Customs Union Commission. In expert opinion, the correlation between them is complicated.

*RBK Daily*

### **Customs Union comes under the jurisdiction of the Single Economic Space**

*October 31, 2011*

The Eurasian Economic Commission (EEC) will replace the Customs Union Commission from July 1, 2012, according to a Eurasian Economic Union draft agreement. The EEC is modelled on the European Commission. The EEC's authority will expand and its staff increase from 150 to 1,200.

According to the draft agreement, the EEC will also be responsible for negotiating and establishing trade partnerships with third countries; it will draft currency, macroeconomic, energy and competition policies; regulate state monopolies and industrial and agricultural subsidies; and be responsible for public procurement, transport, migration, financial markets and other areas.

It is assumed that the EEC decisions will be based on the votes of the Council or Board members (every Board or Council member has one vote). Each country will delegate one Deputy Prime Minister to the Council and three representatives to the Board.

The Prime Ministers of Russia, Kazakhstan and Belarus approved the draft agreement on the EEC on October 19, 2011. The Customs Union Commission declined to comment on the agreement and noted that the CU is now being transferred to the jurisdiction of the SES.

*Expert Online*

## **ESTABLISHMENT OF THE SINGLE ECONOMIC SPACE**

### **International agreements on the Single Economic Space enter into force**

*April 7, 2011*

Moscow hosted the 26<sup>th</sup> session of the Customs Union Commission. The Commission members discussed the common customs territory and the contractual and legal foundations of the Single Economic Space within the framework of the EurAsEC.

The Commission discussed uniform export monitoring procedure for CU member states and approved Customs Union Commission legislation, including

a revised version of the list of goods that are subject to mandatory conformity evaluation confirmed by documentation recognised in all three countries; and a draft provision on standardised checking of conformity to CU technical regulations.

The Commission reviewed customs administration and customs tariff and non-tariff regulations. Members decided to amend the unified commodity nomenclature and the CU's Common Customs Tariff on cast iron and cast steel components for hydraulic turbines; and to adjust import duties on monofilament yarn used in producing filters.

#### Note:

*During the Almaty informal summit in December 2009, the Presidents of Belarus, Kazakhstan and Russia adopted the 2010–2011 Action Plan for the SES. The Plan foresaw the signing of a package of international agreements by January 1, 2012. However, by as early as December 9, 2010 the sides had signed 17 agreements on establishing the SES. The governments were instructed to ratify all the documents by July 1, 2011 and to ensure they entered into force by January 1, 2012.*

*Belarus ratified the whole package of documents on the SES on December 28, 2010. Kazakhstan and Russia completed all procedures necessary to ratify the documents before the deadline.*

*The EurAsEC Interstate Council (the CU supreme body) approved the Action Plan for the implementation of agreements on the SES on March 15, 2011 (decision No.77). The Plan comprises 111 elements, 75 of which must be implemented by the governments and authorised agencies of the three states. The remaining 36 items relating to eight agreements come under the remit of the Customs Union Commission. To realise the Action Plan, a schedule for the preparation of documents implementing Agreements on the SES foresees the development of 13 international agreements and 42 other documents (protocols, procedures, methodologies, criteria, schemes, action plans). The Customs Union Commission approved the schedule on April 7, 2011.*

[www.evrazes.com](http://www.evrazes.com), [www.tsouz.ru](http://www.tsouz.ru)

### SES principles extended to agriculture

*June 9, 2011*

Kazakhstan, Russia and Belarus plan to adopt similar approaches to agricultural subsidies within the framework of the Single Economic Space. Kazakhstan's Majilis ratified and referred this decision to the Senate.

According to the Executive Secretary of the Kazakh Ministry of Agriculture, the agreement on state support to agriculture was drafted by Belarus and signed by the heads of the CU member states on December 9, 2010 in Moscow. The agreement establishes the maximum level of state support that can be granted at 10% of the gross value of agricultural production. Currently, subsidies amount to around 18% of the gross value of agricultural production in Belarus, up to 6% in Russia, and about 4% in Kazakhstan, putting Russian and Kazakh producers at a disadvantage compared to Belarus

State support for agriculture in Kazakhstan will not be limited since an additional 6% would be allowed before it hits the maximum level. Additional state support may be used to encourage local production and increase its competitiveness. Moreover, Kazakhstan will benefit from an additional mechanism for preventing unfair competition and protecting its domestic markets from its main trading partners. The agreement will cease to be effective as soon as the parties join the World Trade Organisation (WTO).

*Kursiv.kz*

### **Kazakhstan, Russia sign up to coordinated exchange policy within the SES**

*July 21, 2011*

So far, only Kazakhstan and Russia have ratified an agreement on coordinated principles of foreign exchange within the Single Economic Space. According to experts, the agreement allows for the creation of a common, gradually unified area to streamline cooperation in capital markets, labour migration and mutual trade. A single currency space may be established in the long term.

The agreement defines how the SES member states will implement foreign exchange policy. It foresees a gradual harmonisation of foreign policy, creation of the legal and organisational foundations for currency integration, and an economic policy focused on boosting confidence in the national currencies of the member states.

The SES countries should pursue economic policies aimed at increasing confidence in the national currencies of its member countries, both on their domestic and on international currency markets. The parties pledge not to intervene in the currency sphere in a way that may adversely affect integration processes, but where forced to act the member states must seek to minimise the consequences of such actions.

The tasks listed in the agreement fall into two categories. Firstly, the approximation of legislation and coordination of foreign exchange policy are necessary to provide equal opportunities for economic entities, including financial institutions, which do not discriminate between residents and non-resident entities. Secondly, the agreement calls for coordinated measures to improve the competitiveness and stability of all three economies within the global economy and global financial markets through the convergence of SES currency markets, national foreign exchange markets, and foreign exchange transactions.

*www.tsouz.ru*

## **New integration milestone reached and Eurasian Economic Union moves ahead**

*November 18, 2011*

The Presidents of Russia, Kazakhstan and Belarus signed the Declaration on Eurasian Economic Integration, and the Agreement on a Eurasian Economic Commission and its functions. These documents should result in the establishment of Eurasian Economic Union by 2015. Simplified regulation of the free movement of goods, services, capital, and labour that will be in force within the Eurasian Economic Union is expected to increase trade flows and lead to a coherent currency and macroeconomic policy.

The Declaration states that the transition to the next stage of integration – the Single Economic Space – will begin on January 1, 2012. The Union will be established by 2015, when the existing legal base of the CU and SES will be fully codified, the Declaration says. The EEC, which will operate from January 1, 2012, will be responsible for the codification process. All the executive bodies will be headquartered in Moscow for the first four years; Russian Industry Minister Viktor Khrystenko will head the EEC Board. The location of the executive bodies will be reviewed once the Eurasian Economic Union is established. The EEC will take over from the Customs Union Commission on July 1, 2012. The EEC will become the supranational authority managing integration within the CU and SES. It will have a two-tier structure with the Council (the upper tier), comprised of the three countries' Deputy Prime Ministers, being responsible for resolving disagreements between members of the Board (the lower tier). The Board will become the EEC's key executive power, responsible for setting duties, establishing sanitary, veterinary and migration controls and monitoring the distribution of industrial and agricultural subsidies.

Some businesses have not waited for the establishment of the Eurasian Economic Union to execute their integration plans. For example, Russia's EuroChem is actively working towards the full-scale implementation of a \$2 billion project in Kazakhstan. LUKOIL plans to commission a large gas-processing complex in Aktobe in Kazakhstan.

*Vedomosti, RBK Daily, Expert Online*

## **EurAsEC ANTI-CRISIS FUND**

### **EurAsEC ACF considers loan to Armenia**

*June 16, 2011*

The EurAsEC Anti-Crisis Fund is studying the prospects for restructuring Armenia's gas and chemical industries. The Armenian government is pursuing a strategy to restore these industries' positions in world markets, and hopes to attract financing from the ACF to implement the programme. Recently



the Chairman of the ACF Council, Russian Finance Minister Aleksei Kudrin, announced that the ACF was considering providing credit to Yerevan.

A number of independent consultants are working on the issue together with the Eurasian Development Bank. The ACF Council may take a decision on lending to Armenia during its next meeting.

**Note:**

*Kudrin first mentioned extending ACF credit of about \$400 million to Armenia at the ACF Council meeting on June 4, 2011 in Kyiv.*

[www.eabr.org](http://www.eabr.org)

### **Belarus receives first tranche of EurAsEC ACF loan**

*June 21, 2011*

Belarus received the first \$800 million tranche of a loan provided by the EurAsEC Anti-Crisis Fund. The next five tranches each totalling \$440 million will be disbursed to Belarus in 2012-2013, while the government programme for stabilising the Belarusian balance of payments and improving its economic competitiveness is being implemented. The programme foresees measures to curb the credit financing of the country's economy, strengthen fiscal discipline, and replenish international reserves to an economically secure level.

**Note:**

*On June 4, 2011 the ACF Council approved a \$3 billion loan to the Republic of Belarus. The Eurasian Development Bank, the manager of the ACF resources, and the government of Belarus signed a loan agreement on June 9. Belarusian President Alexander Lukashenko ratified the agreement and put it into effect on June 15.*

*The credit is extended for 10 years, including a three-year grace period, during which only the interest is being paid. Capital repayments will begin in the second half of 2014.*

*The terms of the loan meet the standard terms and conditions approved by the ACF Council for middle-income member countries. The floating interest rate is tied to the price of Russian funding in international markets (currently around 4.3% per annum) and will be reviewed every three months.*

[www.eabr.org](http://www.eabr.org)

### **Belarus to receive second tranche of EurAsEC ACF loan**

*November 28, 2011*

The Council of the EurAsEC Anti-Crisis Fund approved a second \$440 million tranche of the loan to Belarus pending clarification of components of the country's anti-crisis programme.

The agreement to extend a \$3 billion loan to Belarus from the EurAsEC ACF resources foresees the allocation of several tranches over three years: \$1.24 billion in 2011; around \$800 million in 2012; and \$1 billion in 2013. The ACF funding is expected to help Belarus overcome the foreign exchange crisis that hit the country in spring 2011, and the overall economic crisis triggered by an upsurge in prices and depreciation of currency.

*Expert Online*

## **EDB**

### **Ukraine may join EDB**

*August 19, 2011*

Ukraine may accede to the EDB Foundation Agreement. The Ukrainian government approved the relevant presidential resolution at a meeting on August 17. The government has authorised first Deputy Prime Minister and Economic Minister Andrei Klyuev to address the EDB. Ukraine's contribution to the EDB charter capital may amount to around \$15 million with Kyiv estimating the need for EDB investment at \$2.5 billion. Ukraine's joining the bank will bring economic benefits to the country, help attract additional financial resources for investment projects and enhance cooperation with EDB member states.

#### **Note:**

*The Eurasian Development Bank is an international financial organisation established by Russia and Kazakhstan in 2006 to promote the economic growth of its member states, the expansion of trade and economic ties between its members and the development of integration in Eurasia. The Bank's charter capital exceeds \$1.5 billion and its member states are Russia, Kazakhstan, Armenia, Tajikistan and Belarus.*

*Kursiv.kz*

### **Kyrgyzstan pays its contribution to EDB charter capital**

*August 26, 2011*

Kyrgyzstan has paid its \$100,000 contribution to the charter capital of the EDB, thus completing the procedures required for joining the EDB. It has become the sixth full member of the Bank along with Russia, Kazakhstan, Armenia, Tajikistan and Belarus.

*Kursiv.kz*

## **CSTO**

### **CSTO limits Western influence on post-soviet space**

*December 21, 2011*

Moscow hosted the summits of two major post-soviet integration structures – the Collective Security Treaty Organisation and the CIS.

The CSTO summit adopted measures to limit Western influence on the territory of the former USSR. Russia, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan agreed new rules for foreign military forces deployed at military bases on the territory of CSTO member states. From now on, no foreign military facilities can be deployed in any of the CSTO countries without the sanction of all CSTO member states. This measure will facilitate the CSTO's transition to a fully-fledged military and political bloc, whose participants are focused on the interests of their partners as well as their own financial benefits.

The CSTO countries' leaders approved measures for managing information security in the CSTO member states.

The purpose of the Collective Rapid Reaction Force (CRRF) has been changed to focus on preventing destabilisation of CSTO countries. Initially, the CRRF responded to military aggression from the exterior, and counteracted international terrorism, organised crime, drug trafficking and the effects of disasters. From now on, the CRRF may also be engaged in protecting the constitutional position of CSTO member states. The summit agreed that the CSTO's role will be to counteract real and virtual threats from the West and from the South – the Presidents discussed a plan of action in case the security situation in Afghanistan deteriorates after the withdrawal of NATO troops in 2014.

*Kommersant*

## SCO

### Vital SCO development issues

*June 16, 2011*

Over the ten-year history of the Shanghai Cooperation Organisation (SCO), the organisation's balance of authority has shifted towards Beijing. China has demonstrated its commitment to large-scale penetration of SCO member country economies. As a result, Russia finds itself bound up with China's strategy, being able only to observe the process but not significantly to influence it. One way to stabilise Russia's position in the SCO, according to analysts, is to create a free trade area in the post-soviet space and gradually expand into the SCO. This idea was voiced by the Russian delegation during 2011 Astana summit. Moreover, Russian President Dmitry Medvedev proposed that the SCO should draw up a "road map" for multilateral trade and industrial cooperation by the end of 2011.

Opening doors to new members may become a turning point in the integration processes within the SCO. The SCO is on the cusp of expected expansion. In recent years, many powerful states have expressed their intention of becoming full members of the organisation. Some of these countries are, however, burdened with complex problems. Discussion of Iran's potential membership of

the SCO was suspended in late 2009, when Russia stated that countries placed under UN sanctions on security grounds could not be admitted to the SCO. Meanwhile, Moscow welcomes India's declared intention of joining the SCO, since the latter can act as a counterweight to the influence of Beijing. However, because of the serious competition between India and China – the two major powers of Eurasia – this step is quite difficult to realise. The summit showed that Afghanistan appears to be another preoccupation of those wishing to further SCO expansion. As the US withdrawal from Afghanistan becomes inevitable, and Hamid Karzai's administration is actively taking over control, the SCO is obliged to take into consideration the future of the Afghan state.

Kazakh President Nursultan Nazarbayev put forward a number of initiatives during the anniversary summit of the SCO in Astana, including a proposal to establish a common energy space in SCO member states.

The delegates also returned to the question of establishing an SCO Special Account, the resources of which could be used for the technical and economic evaluation of large-scale projects. The SCO Special Account should become a "liquidity cushion" for projects that have great integration potential. However, creating such a fund is part of a broader plan to establish a joint fund to finance projects within the SCO, and its authorised body. So far the SCO member states have failed to reach consensus on the structure of this body. Beijing insists on creating a separate structure, while Moscow has suggested it should be based on the Eurasian Development Bank, the majority of which is owned by Russia and Kazakhstan.

China has taken the lead in granting loans to SCO member states. Chinese President Hu Jintao reminded the summit that in 2009 China pledged to provide \$10 billion in concessional loans to SCO member states. However, the country has significantly exceeded its obligations. Kazakhstan has received \$15 billion in credits from China in the last two years. At the peak of the economic crisis, Russian companies Rosneft and Transneft borrowed \$25 billion from China Development Bank.

Russia does not view these developments as a threat to Russian interests in Central Asia, claiming rather that China's greater flexibility in the SCO and proposed financial instruments merit comprehension and support.

*www.sco.org, Kommersant, Kursiv.kz*

## TRADE AND INVESTMENTS

### **Russian enterprises move to Kazakhstan**

*April 4, 2011*

Boris Titov, head of the Business Russia organisation, claims production costs in Russia are too high, especially in industries bearing the cost of

growing tariffs of natural monopolies. Over the last five years production costs have increased threefold owing to rising tariffs and inflation rates, he says.

In 2010, industrial growth recovered, but slumped again after the uniform social tax increase in 2011 and another round of tariff increases. Loans are exceedingly expensive while long-term credit facilities do not exist at all, Titov claims. Manufacturers with a long production cycle have a slower turnover rate. As a result, only 22% of manufacturers are financed by borrowing, while the rest invest from their own resources.

In contrast, Kazakhstan's producers have a lighter tax burden and tariff increases are limited by the authorities. The interest rate is lower and long-term credit facilities are more widely available.

Therefore, Russian industrial enterprises began relocating to Kazakhstan after the establishment of the CU and the introduction of agreements regulating industrial activity. A plant cannot be moved within a couple of days, of course, so this is a slow process taking place over several years. The CU makes it more profitable to produce in Kazakhstan and sell in Russia because customs duties have been abolished and Russian demand and prices are higher. If the situation remains unchanged, the relocation of production to Kazakhstan will accelerate.

*Kommersant*

### **Customs Union protective measures**

*June 6, 2011*

The policy of the CU is becoming more protectionist. The CU's most recent measures have been directed against Ukraine. The Customs Union Commission has decided to apply antidumping and special protective measures in Russia, Belarus and Kazakhstan against Ukrainian steel pipes, fibreglass, and engineering fasteners and fittings.

Russia's Ministry of Economic Development and the Ministry of Economy of Ukraine signed an agreement regulating the supply of certain types of steel pipes. Russia's Ministry of Industry and Trade proposed extending the validity of duties on over-quota imports of steel pipes from Ukraine for five years from January 31, 2011, and increasing the current duty rate.

Previously, on December 30, 2010, Ukraine and Russia had signed an agreement to increase quotas for duty-free imports of Ukrainian pipes to Russia to 300,000 tonnes in 2011. If CU member states sign relevant agreements with Ukraine, this measure will be valid throughout the Union.

*Expert Online*

### **Belarus introduces export restrictions**

*June 13, 2011*

Belarus has introduced restrictions on the export of food products and banned the export of some other commodities. The government introduced these trade measures to protect domestic market.

Special charges equivalent to double their average price have been imposed on exports of pork and poultry meat; sugar; flour; rennet cheese; butter; tobacco products manufactured in Belarus; canned meat and dairy products.

A temporary ban has also been imposed on individual exports of household refrigerators and freezers manufactured by JSC Atlant; gas cookers (manufactured by the Belarusian-Russian joint venture Brestgazoapparat), cement (produced by JSC Krasnoselskstroyaterialy, RUE Belarusian Cement Plant, Krichevcementnoshifer Ltd.), detergents (JSC Barhim), cereals (various) and all pasta, regardless of manufacturer.

From June 11 Belarus is also restricting exports of motor fuel. Exporting such fuel more than once every five days requires the exporter to submit a customs declaration and pay customs duties. Restrictions and bans are valid only when goods are exported outside the CU – trade terms with Russia and Kazakhstan remain unchanged.

*Kursiv.kz*

### **Bottlenecks remain on Russian-Kazakh border**

*June 16, 2011*

So far there has been no resolution of the problem of goods entering Kazakhstan under preferential customs duty rates, then being taken into Russia. Russia is very concerned about this emerging “window” through which imports of cheap cars, gasoline, medicines, cigarettes and alcohol from Kazakhstan could be channelled.

The abolition of customs checks at the Russian-Kazakh border from July 1, 2011 was announced a year ago when the common customs territory between Russia, Belarus and Kazakhstan came into effect. A year-long transition period was allowed because of the perceived permeability of Kazakhstan’s borders with other countries, primarily China.

Kazakhstan imports 70% of the goods its economy requires. Kazakhstan negotiated special conditions when it joined the CU, including lower duty on cars imported by individuals (until July 1, 2011), a zero rate on raw cane sugar (until 2020), a zero rate on aircraft (until July 1, 2014) and aircraft spare parts (unlimited).

The EurAsEC Interstate Council also approved Kazakhstan's list of lower-duty imports (compared to the common customs tariff) on 409 goods, including medicines, medical equipment, cars, raw materials for chemical, light and woodworking industries, aluminium, paper, etc. The validity period of these rates vary, none going beyond the year 2015.

The Russian authorities granted these concessions in 2009 to ensure Kazakhstan signed certain key CU documents; however, Russia is now concerned that goods imported into Kazakhstan from other countries at lowered duty rates will appear on the Russian market once the customs barrier is removed.

During a meeting of the EurAsEC Interstate Council in Minsk on May 19, 2011, Kazakhstan pledged to introduce state control over the "privileged" products by July 1, 2011 and made assurances that such goods would not be brought to Russia.

*Kommersant*

### **Russia's accession to WTO: Perspective from Tbilisi**

*November 7, 2011*

As part of negotiations on WTO accession, Russia and Georgia have solved the problem of monitoring cargo on the Russian border with Abkhazia and South Ossetia. Georgia refused to agree to Russia's accession to the WTO unless Russia submitted information on products coming in to the two republics. On November 3, 2011 the head of the Russian Delegation at the WTO accession negotiations Maxim Medvedkov announced that Russia has approved a compromise agreement with Georgia, proposed by Switzerland. Georgia approved the compromise on October 27.

The issue of observers was a problematic one during the Swiss-mediated negotiations. The parties agreed to select a special company that will be responsible for acquisition of data on cargoes at the checkpoints and transferring the data to Georgia in electronic form. The mechanism and criteria for selecting an operator were not disclosed, but a company is shortly to be selected by Switzerland. Under the agreement, Georgia will receive information on goods transported via three trade corridors. The first corridor will run from the river Psou on the border with Abkhazia to Zugdidi in the west of Georgia. The second will lie on the border with South Ossetia from the north side of the Roki Tunnel to Gori in Georgia. The third will be at the Kazbegi-Upper Lars checkpoint, the only official crossing on the land border between Georgia and Russia.

This transfer of border controls to a private company is unique. The US Congress is considering transferring the authority to control the US border with Mexico to a private operator.

*Vedomosti*

## Russia accedes to the WTO

*November 10, 2011*

The WTO Working Party has approved Russia's accession to the WTO. A formal decision on Russia's WTO membership will be adopted at the WTO Ministerial Conference on December 15-17. According to Maxim Medvedkov, head of the Russian Delegation at the WTO accession negotiations, Russia will have six months to ratify the WTO membership agreement, which comes into force one month after the ratification date, so Russia will become a full WTO member in summer 2012.

According to information on the WTO website, the average import duty in Russia will decline from 10% to 7.8% by 2020: from 13.2% to 10.8% for agricultural products, from 9.5% to 7.3% for industrial goods, from 19.8% to 14.9% for dairy products, and from 15.1% to 10% for cereal crops. Duties on cars will be reduced from 15.5% to 12%, on electric vehicles – from 8.4% to 6.2%, and on wooden and paper products – from 13.4% to 8%.

Duties will be reduced gradually. First of all Russia will have to bring down its anti-recessionary duties (e.g., on chemicals and metals), and as soon as Russia becomes a WTO member, duties on new motor cars will be reduced from 30% currently to 25%, and further to 15% within the next seven years.

Officials believe Russia is joining the WTO on advantageous terms. Lower duties on foodstuffs are unlikely to seriously affect the domestic market, while higher duties on motor vehicles will be in place until the year 2018. Moreover, Russia has undertaken to reduce federal subsidies to the agricultural sector from \$9 billion in 2012 to \$4.4 billion in 2018.

Contrary to expectations, there will be no reform of the gas market. Under WTO terms and conditions, the government is allowed to regulate domestic gas prices as long as they bring profits to the national gas utility, Gazprom. Moreover, the gas giant will remain a monopoly in terms of gas exports.

With regard to the banking sector, Russia's WTO membership terms state that foreign banks are allowed to operate via their subsidiaries but may not open branch offices and foreign capital in the Russian banking sector may not exceed 50%. Foreign insurers will be allowed to open branch offices nine years after Russia's accession to the WTO.

Russia has promised to lift all restrictions on foreign capital investment in its telecommunications sector by 2015. This industry is listed as strategic and companies taking a controlling stakes in telecommunications companies in Russia must have their investments approved by the government.



*December 16, 2011*

WTO trade ministers accepted Russia's bid to join the WTO. The accession protocol was signed by Russian Economic Development Minister Elvira Nabiullina and WTO Director General Pascal Lamy.

Russian Deputy Prime Minister Igor Shuvalov, President of the Swiss Confederation Micheline Calmy-Rey, and WTO ministers attended the accession signing ceremony.

Earlier the WTO ministerial conference had approved all documents relating to Russia's accession to the organisation including commitments on market access for goods and services. Russia has been working towards joining the WTO since 1993.

Russia's membership in the WTO marks an important milestone in its history, but there is hard work still to be done.

First of all Russia will have to determine the rules of its international trade, including the trade regime with the US. The Jackson-Vanik amendment, which limits trade with Russia and which is an obstacle to the application of WTO rules between the two countries, would have to be revoked. Failure to do so would allow Russia to deny the United States preferential access to its markets, and WTO rules will not apply to trade between Russia and the US before it is repealed.

Moreover, during the next six months the Russian government must decide terms of access to Russian markets for goods and services, which give the country room for manoeuvre. Russia needs to define its strategy in many areas, particularly in the services sector and with regard to systemic issues. According to the Ministry of Economy, the government and the Central Bank must first decide whether or not to introduce a 50% quota for foreign bank control of the aggregate capital of Russian's banking system.

In addition, around one-third of tariff rates under the Russian Federation's WTO commitments are higher than those applied within the framework of the CU, so Russia, Kazakhstan and Belarus will have to decide what rates to apply.

Meanwhile, Russian businessmen will have to explore a new instrument – the WTO dispute settlement system, a mediation mechanism aimed at reducing barriers to trade which was unavailable to Russia before the official accession. Maxim Medvedkov, director of the Trade Negotiations at the Ministry for Economic Development, who has led the negotiations on Russia's WTO accession for the last 11 years, believes that Russia should raise grievances over at least 120 trade barriers imposed by its trade partners. He cites the EU's reluctance to accept Russian energy prices, especially on gas, when estimating the cost of Russian products. Moreover, WTO membership gives Russia an

opportunity to use the WTO dispute resolution mechanisms in trade with China. Prior to this, Russia had no formal grounds for asking China to reduce barriers to Russian goods.

The government will also have to learn to offer state support in ways that conform to WTO rules prohibiting direct subsidies that affect the pricing of goods. However, the Ministry of Economy is confident that the existing structure of state support demonstrates a 99% compliance with WTO rules.

*Vedomosti, Expert Online, RIA Novosti, Kommersant, Finam.ru*

## BILATERAL RELATIONS

### Transport, space and other aspects of Russian-Ukrainian cooperation

*April 13, 2011*

Russian Prime Minister Vladimir Putin visited Kyiv and met with his Ukrainian counterpart Nikolay Azarov to discuss a new gas contract and Ukraine's accession to the CU.

Talks on Ukraine's possible entry into the CU began about a year ago. The scope of economic cooperation between Russia and Ukraine is larger than between Russia and the other two member states of the CU. Businesses in Ukraine and Russia want to simplify customs procedures. In addition, if Ukraine joins the CU it could benefit from a significant discount on Russian gas prices. In early April, the Ukrainian authorities announced that the country may accede to the Protocol establishing the CU as early as June 2011. According to the President of Ukraine, Viktor Yanukovich, the country is ready to cooperate with the CU on a 3 + 1 basis, meaning Ukraine's accession to selected CU agreements only.

Putin also noted that Ukraine's accession to the CU would make it easier for the country to negotiate a free trade area with the EU. In recent years Ukraine's policy makers have been in search of a formula that will allow them to cooperate both with the EU and the alliance of Russia, Belarus and Kazakhstan.

Nikolay Azarov reminded his Russian counterpart that if Ukraine joins the CU, Moscow would have to cut the cost of its energy resources significantly. Ukraine's Prime Minister also noted that Kyiv needs firm guarantees from Moscow on the volumes of gas flowing to Europe, and hoped Russian companies would participate in the reconstruction of the Ukrainian gas transit system.

Azarov stated that Russia and Ukraine should, in the short term, finalise preparations for a feasibility study on a transport crossing over the Kerch Strait.

He also noted that Ukraine would be ready to sign up to the provision of a high-speed rail link between Kyiv and Moscow in the near future and invited Russia to simplify customs controls as soon as possible.

In addition, Ukraine's Prime Minister said that the Russian-Ukrainian joint venture between Ukraine's state aircraft manufacturer and Russia's United Aircraft Corporation (UAC) needed to be finalised. In March, UAC and ANTONOV signed an agreement to purchase and sell a 50% stake in the UAC-Civil Aircraft Management Company, on which the joint Russian-Ukrainian company UAC-ANTONOV would be based. The joint venture will be engaged in mass production of AN-140, AN-148 and AN-158 passenger aircraft, as well as AN-70 and AN-124 transport aircraft. The two countries may also launch joint production of aircraft engines.

Potential cooperation between Ukraine and Russia in other aerospace projects was also discussed. Vladimir Putin invited Ukraine to participate in the construction of the new Vostochny spaceport, which is being built in Russia's Far East. The spaceport will give Russia its own independent launch pad into space. At present, all manned flights are launched from the Baikonur spaceport in Kazakhstan, which Russia leases. Construction of the Vostochny spaceport is due to begin in summer 2011; the first rocket launch will take place in 2015, and construction of the whole complex is due to be completed in 2016. The launch of manned spaceflights from Vostochny is expected in 2018.

*RIA Novosti, Expert Online*

### **Russian and Tajik Presidents discuss labour migration**

*September 2, 2011*

During an official visit to Tajikistan, Russian President Dmitry Medvedev met with his Tajik counterpart Emomali Rahmon to discuss the problems migrant workers are facing in Russia. Both heads of states underlined the importance of creating decent conditions for Tajik labour migrants in Russia, including their pre-migration vocational training, and of reinforcing these conditions in law. In their joint statement the Tajik President acknowledges that Tajik migrants must abide by the laws of the host country. Both countries condemned manifestations of nationalism and xenophobia, including incitement to hatred and violence against citizens of another ethnicity. They also noted the importance of adopting laws to prevent such manifestations. Cooperation between law enforcement and immigration authorities in the two countries must be improved to that end, they said.

*Expert Online*

### **Armenian President visits Russia**

*October 25, 2011*

Armenian President Serzh Sargsyan made a three-day state visit to Moscow on October 23-25. Currently Armenia is Russia's sole ally in the South Caucasian region. Yerevan is building relations with Moscow, Tehran,

Washington, Brussels and Tbilisi. Armenian policymakers are cooperating with all these states and complying with international commitments. Russia is playing an important role in ensuring the security of the Armenian state, which is sandwiched between Turkey and Azerbaijan.

During the visit various documents were signed, including an agreement on cooperation in humanitarian work; leasing of real estate in Armenia and Russia in order to set up diplomatic missions; a memorandum of cooperation on combating infectious diseases; and a memorandum of cooperation between the Foreign Ministries of Armenia and Russia. Armenia and Russia also signed an agreement on removing double taxation on income and property, which both parties agree will boost cooperation between the two countries.

Fostering trade and economic cooperation with Russia is an important task for Armenia. Today Russia is a major investor in the Armenian economy. Russian companies provide Armenia with consistent natural gas supplies, and are active in the electricity industry. A fifth unit at the Hrazdan thermal power plant is soon to be commissioned. According to Russian President Dmitry Medvedev, Russian investment in Armenia's economy already exceeds \$2.8 billion.

*Expert Online*

### **Somersault in Russian-Tajik relations**

*November 22, 2011*

*November 8, 2011* – A Tajik court has sentenced Russian pilot Vladimir Sadovnichy and his Estonian colleague Alexei Rudenko, who were working for the Rolkan Investments Airline, to eight and a half years in prison each for border violations and smuggling. The two ANTONOV AN-72 transport aircraft they had been flying were confiscated.

*November 11, 2011* – The case of the two convicted Russian airline pilots was discussed at interparliamentary level. Tajik President Emomali Rahmon assured the Russian Ambassador to Tajikistan of his readiness to help Moscow resolve the situation. The pilots' lawyers, in turn, filed a cassation appeal.

*November 12, 2011* – Tajik President Emomali Rahmon took the case under his personal control.

*November 14, 2011* – Russian President Dmitry Medvedev urged Tajik authorities to reconsider the case against the Russian and Estonian pilots.

*November 15, 2011* – The head of Rospotrebnadzor, Russia's chief medical officer Gennady Onishchenko, stated that HIV and tuberculosis infection rates are high among migrants from Tajikistan, and suggested that Russia should consider a ban on migrant workers from Tajikistan until the country

can establish satisfactory public health standards. The Federal Migration Service began authorising the detention of illegal migrant workers from Tajikistan. As at November 14, Russian law enforcement agencies have detained 297 migrants.

*November 15, 2011* – The Prosecutor's Office in Tajikistan's Khatlon region has made an official protest against the conviction of pilots Vladimir Sadovinichy and Alexei Rudenko, sentenced to 8.5 years each in a maximum security penitentiary.

*November 22, 2011* – The Cassation Committee of the Khatlon Regional Court overturned the verdict handed down on November 8 and both pilots were released by the court. The Prosecutor's Office in Khatlon, Tajikistan, stated that a criminal case against the chief executive of the company Rolkan Investmens Ltd., Sergei Poluyanov, has been suspended and will be transferred to Tajikistan's law enforcement agencies, Afghanistan's special services and Russia's Federal Security Service.

*RIA Novosti, Rossiyskaya Gazeta, Vedomosti*

### **Kazakhstan, Kyrgyzstan address reservoir problem**

*November 28, 2011*

The dangers posed by aging dams have prompted greater cooperation between Kazakhstan and Kyrgyzstan as they seek to ensure uninterrupted water supplies and prevent catastrophic flooding.

Relevant authorities in both countries are negotiating the allocation of funding by Kazakhstan to repair Kyrgyz reservoirs vital to both countries. Experts have stressed the need for the two countries to resume relations that were ended by the Soviet Union's collapse.

The South Kazakhstan and Zhambyl oblasts in Kazakhstan suffer from irregular water supplies; they are also at risk of flooding because of the dilapidation of reservoirs and canals along the border with Kyrgyzstan. Officials of both countries are striving to improve the situation.

In October 2011 Kazakhstan offered Kyrgyzstan \$500,000 (73.9 million tenge or 23.4 million Kyrgyz som) to fix reservoirs that, according to Bishkek officials, are vital in providing uninterrupted drinking and irrigation water supplies to Kazakhstan.

Most of the reservoirs' infrastructure was built in the 1970s to increase substantially the amount of water available to irrigate farmland in the Zhambyl and South Kazakhstan oblasts. The infrastructure has an estimated life span of 100 years.

*centralasiaonline.com*

## ECONOMIC SECTORS

### OIL AND GAS

#### Belarus

##### **Belarus raises tariffs for transit of Russian oil**

*January 11, 2011*

Belarus will increase tariffs for the transit of Russian oil to Europe by 12.5% from February 1, the Belarus Ministry of Economy said. The decision was taken under an agreement between Belarus and Russia on setting tariffs on oil-product transportation via the trunk pipelines of Belarus.

From February 1, tariffs on oil transported through the Gorneltransneft Druzhba and Polotsktransneft Druzhba pipelines in Belarus will also increase by 12.5% compared to 2010.

According to the Belarusian Ministry of Economy, the tariff increase was necessitated by a change in economic conditions surrounding oil supplied by Russia and transported through oil pipelines in Belarus.

*Finam.ru, RBK daily*

##### **Problems with Russian oil supplies to Belarus**

*January 21, 2011*

In December 2010 the Presidents of Russia and Belarus, Dmitry Medvedev and Alexander Lukashenko, agreed that all export duties on Russian oil processed in Belarus would be transferred in full to the Russian budget. In turn, Moscow would supply oil to Belarus duty-free (the amount planned for 2011 was set at 21.7 million tonnes). These arrangements are valid under the Single Economic Space between Russia, Belarus and Kazakhstan.

However, Russian oil companies cut off oil supplies to Belarus on January 1, 2011 citing an absence of contracts for the year. To protect the profitability of oil deliveries to Belarus and other countries, the Russian oil companies intended to increase the price of oil supplied to Belarus by \$45 per tonne. Belarus' protest over this increase has led to nearly a month of negotiations while both sides tried to reach a solution. Crude reserves at Belarusian refineries have been gradually decreasing, their operations were threatened, and Russia has been redirecting oil meant for Belarus to the Russian ports of Primorsk and Novorossiysk, Gdansk in Poland, and to Russian and Ukrainian oil refineries. The largest deliveries of oil were due to be supplied to Belarus during the first quarter of 2011 by LUKOIL (1 million tonnes), Surgutneftegaz (1 million tonnes) and Rosneft (0.9 million tonnes).

*January 25, 2011*

Transneft resumed oil deliveries to Belarusian refineries after Minsk agreed to pay \$46 per tonne of crude oil. 21.7 million tonnes of oil may be supplied to Belarus this year, including 18 million tonnes delivered by pipelines.

*RBK daily, Vedomosti*

**Agreement on paying customs duties on oil exported from Belarus beyond the Customs Union territory submitted to State Duma**

*July 8, 2011*

The President of Russia Dmitry Medvedev submitted the Agreement on Customs Duties (and Other Similar Duties, Taxes, and Levies) Payment and Deposit Procedures for Crude Oil and Certain Petroleum Products Exported from Belarus beyond the Customs Union Territory to the State Duma for ratification. The agreement was drafted under a resolution of the Customs Union Commission dated October 14, 2010, and was signed in Moscow on December 9, 2010.

The agreement sets out procedures for the collection and reimbursement of export duties (and other similar duties, taxes and levies) on oil and certain oil products exported from Belarus beyond the CU. It also regulates the collection and reimbursement of penalties for non-payment or partial payment of export duties in cases specified in CU law, the legislation of Belarus and the agreement. The agreement does not apply to the collection and reimbursement of export duties (and other similar duties, taxes and levies) on oil produced in Belarus and then exported beyond the CU.

According to the agreement, liability to pay export duties (and other similar duties, taxes and levies) is regulated by the Customs Code of the CU. Where goods are exported from Belarus beyond the CU, export duties shall be the same as those effective in the Russian Federation on the day the Belarusian customs authorities register the export declaration.

Article 5 of the Agreement stipulates that, given the technological and transport advantages of the republic's oil refining industry, and the quality of oil, Belarus has the right to set an additional mandatory fee payable to the state budget over and above the export duties paid to the Russian government. Procedures for paying the additional duty and for transferring it to the state budget will be defined by Belarusian laws. Article 6 of the Agreement stipulates that export duties and penalties on goods Belarus exports outside the CU must be paid to Russia in US dollars. The agreement establishes rules additional to the Russian Federation's laws, and therefore is subject to ratification pursuant to the Federal Law "On International Treaties of the Russian Federation".

*Finam.ru*

## Belarusian gas debt increases

November 15, 2011

Gazprom claims that in the third quarter of 2011 Belarus paid 12% less than the contract price for its gas deliveries. In February–April, and in July 2011, Beltransgaz “violated the terms of its contract” in paying for Russian gas, Gazprom claims. Beltransgaz asked Gazprom if it could defer payment for gas delivered in the third quarter of 2011 and pay \$245 per 1,000 m<sup>3</sup> (the contract price for the second quarter of 2011). The contract price for the third quarter was supposed to be \$279.16. With a total of 4.231 billion m<sup>3</sup> of gas delivered to Belarus during the third quarter of 2011, the underpayment is about \$144.5 million.

If Belarus were to continue to pay \$245 per 1,000 m<sup>3</sup> for gas in the fourth quarter, the country’s debt may top \$490 million by year-end, given that Gazprom was due to supply Belarus with a total of 6 billion m<sup>3</sup> during the fourth quarter at a forecast price of \$303 per 1,000 m<sup>3</sup> (based on the latest version of the company’s budget for 2011).

### Note:

*Gazprom and Beltransgaz dispute gas payment almost every year. The latest conflict began after Belarus continued to pay average 2009 gas prices during the first four months of 2010, instead of the higher contract price, which led to a debt of around \$190 million. Gazprom threatened to cut supplies and Minsk brought up the issue of Gazprom’s debts for gas transit. Gazprom carried out its threat to cut gas supplies to Belarus for a few days, which meant Europe also faced a reduction in its gas supplies. Fortunately, the conflict was resolved before the EU was affected. This year’s difficulties have not triggered an open conflict between the states. By February, Beltransgaz owed Gazprom \$70 million but it paid the debt in April, Gazprom stated in its report for the second quarter of 2011.*

*Vedomosti*

## Belarus sells Beltransgaz to Gazprom

November 25, 2011

Intergovernmental agreements on Gazprom’s acquisition of a second 50% stake in Beltransgaz for \$2.5 billion were signed during the session of the Supreme State Council of the Union State of Russia and Belarus at the Gorky residence near Moscow. Gazprom purchased the first 50% stake in Beltransgaz back in 2007 for the same price. Along with \$2.5 billion payment for Beltransgaz, Belarus was granted a substantial discount on gas prices (in 2012 Belarus will purchase gas at \$166 per 1,000 m<sup>3</sup> compared to the current \$250) and a loan of \$10 billion for 15 years for the construction of a nuclear power plant. The deal amounted to a total of \$12.5 billion, and with the gas discounts Belarus will be able to reduce its current account deficit from \$7 billion to \$4 billion per year.

*Kommersant, Expert Online, Vedomosti*



## **Russia, Belarus agree upon oil deliveries**

*December 24, 2011*

Russian and Belarusian oil companies agreed terms for Russian oil deliveries to Belarus for refining and subsequent export of oil products outside the CU in 2012-2015. While in 2011 Russia supplied oil to Belarus at a premium of \$46 per tonne (Rotterdam netback), in 2012 a discount of \$3.7 per tonne will be applied. Moreover, Russian oil companies acquire the right to refine up to 50% of pipelined oil based on contracts with the owners of Belarusian refineries.

Under the CU and SES agreements signed by Belarus, zero-duty deliveries of Russian oil were to begin on January 1, 2011, on condition that 100% of export duties on oil products exported from Belarus outside the CU territory are paid to the Russian budget. The overall loss to the Russian budget is estimated at \$2.2 billion. Another 6-8 million tonnes of oil products produced from Russian oil were consumed in Belarus and not subject to export duties. However, Belarus did not receive Russian oil in early 2011. The subsequent export of oil products gave Belarusian refineries extra revenue of over \$100 per tonne and Russian companies demanded their share either in the form of a quota on oil refining in Belarus for independent exports of oil products or an additional premium on the oil price. Eventually, the sides shared the extra income equally, agreeing on a premium for Russian companies, which amounted to around \$46 per tonne.

However, from October 1, 2011 Russia introduced a new tax regime for the oil industry, the so-called "60-66" regime, which reduces export duties on crude by around 7% and increases duties on oil products from 55% to 66% of the export duty on crude oil with the simultaneous harmonisation of export duty rates for light and heavy refined products.

The gap between the duties on crude oil and oil products contracted significantly, as did the profitability of Belarusian refineries, giving Russian companies the opportunity to snap up processing quotas. By recycling half of the oil they supply to Belarusian refineries, Russian companies will collect the difference between the export duties on oil and petroleum products. However, in monetary terms, it makes virtually no difference.

*Kommersant*

## **Ukraine**

### **Russian oil companies bear losses in Ukraine**

*February 1, 2011*

Russian oil companies have suspended their refining operations in Ukraine. LUKOIL closed its Odessa Refinery for reconstruction in autumn 2010, and TNK-BP decided to suspend operations at its Lisichansk Refinery for at least

the first quarter of 2011. In January-September 2010 TNK-BP's Ukrainian companies (Lisichansk refinery and TNK-BP Commerce) made losses totalling approximately \$60 million. If current trends on the Ukrainian oil refining market continue, the company's losses in Ukraine will amount to \$150 million in 2011. The investment programme for 2011 (about \$160 million) is currently frozen.

TNK-BP owns Lisichansk oil refinery (the second largest in Ukraine), 150 petrol stations, and around 275 independent petrol stations which are operating under the company's name.

According to the Ukrainian Ministry of Fuel and Energy, imports of oil products to Ukraine grew from 3.8 million to 4.5 million tonnes in 2010, accounting for about half the market. Because of the "preferential pricing of raw materials", imported oil products have a cost advantage of more than \$100 per tonne over Ukrainian production. Imports from Belarus to Ukraine, thus, grew by 17% during 2010.

The inception of the Single Economic Space and zero-duty Russian oil deliveries to Kazakhstan and Belarus will make imports of oil products to Ukraine even more profitable, exacerbating the Ukrainian refineries' situation. The smuggling of oil products into Ukraine is increasing and individual companies are taking increasing advantage of tax optimisation schemes. Ukraine must solve the problem by investigating imports of oil products, preventing smuggling and "back-door" trading, and by imposing import duty on oil products. The Ukrainian authorities have already mentioned the possibility of imposing duties, but no final decision was taken. Although such duties would help refiners, they would also trigger further increases in the price of oil products.

*Kommersant*

### **New arguments to support Gazprom and Naftogaz merger**

*February 21, 2011*

Gazprom is trying to persuade Ukraine of the feasibility of its merger with Naftogaz. According to Gazprom, the average gas price for Ukraine will reach \$280 per 1,000 m<sup>3</sup> in 2011 (\$264 in the first quarter and \$275 in the second quarter of that year), and around \$300 per 1,000 m<sup>3</sup> in 2012. Meanwhile, gas transit through Ukraine will cost Gazprom \$2.7-2.75 billion in 2011, or \$100 million more than in 2010. Gas supplies will increase by 9.7% to 40 billion m<sup>3</sup>. The head of Gazprom, Alexei Miller, stated that the company has no plans to revise the stated contract price downwards.

However, Miller noted that if Ukraine's state energy company Naftogaz merges with the Russian gas giant, gas supplied to Ukraine will be priced the same as domestic Russian supplies to households and industry. Russian Prime Minister Vladimir Putin first proposed the idea of a merger between Gazprom and Naftogaz in early May 2009.

Moreover, Gazprom CEO said that Russia would make maximum use of Ukraine's pipeline capacity. The current loading level stands at around 95 billion m<sup>3</sup> per year, but with investment the capacity of Ukraine gas transportation system could increase to 125 billion m<sup>3</sup> per year. According to Miller, the system could potentially carry up to 140 billion m<sup>3</sup> of gas annually.

Miller said that Ukraine's gas transportation infrastructure requires serious investment over the medium term and that the country should decide how to develop the industry. In 2010 Ukraine allocated \$212 million to the modernisation of its gas transportation system and plans to allocate \$300 million more in 2011.

**Note:**

*Russian Prime Minister Vladimir Putin suggested merging Gazprom and Naftogaz at a Ukrainian Interstate Commission economic cooperation meeting in April 2010 in Sochi. In December 2010 Gazprom head Alexei Miller and Ukraine's Minister for Energy and the Coal Industry Yuri Boiko agreed to establish two joint ventures, one to produce coal-bed gas in Ukraine and the other to develop the Pallas gas field in the Black Sea. Gazprom and Naftogaz also signed a memorandum of understanding on the production of methane from coal seams. Gazprom's Board of Directors instructed the company's executives to continue working with Ukraine on establishing hydrocarbon joint ventures.*

*Kommersant, RIA Novosti*

**Gazprom: Ukraine may benefit from pricing within Customs Union**

*April 7, 2011*

According to Gazprom estimates, Ukraine could save around \$8 billion annually if it joined and benefited from the price regime in the CU. Ukraine currently receives gas priced according to a European price formula.

Whether or not Ukraine will join the CU depends on the country's negotiations on a free trade area with the EU.

The Ukrainian authorities have repeatedly said Gazprom's prices are unaffordable for the country's economy and demanded revision of existing gas contracts. Although Kyiv has already received a discount of \$100 per 1,000 m<sup>3</sup> of gas, the Government of Ukraine believes the cost is still too high. Ten-year contracts for Russian gas supply to Ukraine and its transit through the country were signed by Gazprom and Naftogaz in January 2009. The gas contract allows for quarterly price changes, which are calculated according to the generally accepted European formula.

In April 2010 the two sides agreed a 30% discount on the gas price for Ukraine with a maximum discount of \$100 per 1,000 m<sup>3</sup>. In return, Ukraine extended the lease allowing Russia's Black Sea Fleet to be stationed in Crimea.

**Note:**

*In 2010 Ukraine imported 36.5 billion m<sup>3</sup> of gas from Russia and plans to import around 40 billion m<sup>3</sup> in 2011. During the first half of 2011 Ukraine purchased about 27 billion m<sup>3</sup> of Russian gas. According to the summer contract between Naftogaz and Gazprom, the gas price is reviewed on a quarterly basis based on an oil price matrix. Thus, the gas price for Ukraine may increase to \$354 per 1,000 m<sup>3</sup> in the third quarter of 2011 and \$388 per 1,000 m<sup>3</sup> in the fourth quarter (prices are \$264 per 1,000 m<sup>3</sup> in the first and \$297 per 1,000 m<sup>3</sup> in the second quarter of 2011). Ukraine has repeatedly asked for the contract terms to be changed and for the gas price to be tied to coal prices.*

*Expert Online, RBK daily, top.rbc.ru*

### **Gas issue burdens Ukrainian-Russian relations**

July 11, 2011

Ukrainian President Viktor Yanukovich has declared there will be no merger between Gazprom and Naftogaz of Ukraine. Gas prices remain a major problem for Kyiv. However, Gazprom chief executive Alexei Miller explicitly linked the possibility of lowering Russian gas prices for Ukraine with the merger of Gazprom and Naftogaz. Thus, the parties have come to a deadlock in negotiations, which will be very difficult to work through.

The merger with Naftogaz could enable Gazprom to influence the Ukrainian gas transportation system (GTS), and thus significantly reduce the export risk on this route. However, its sole participation in modernising the GTS is no longer attractive. Belarus ceded control over its pipeline to Gazprom in exchange for lower gas prices. Ukraine's reluctance to follow suit is politically motivated.

Raising tariffs for gas transit and becoming embroiled in gas conflicts will eventually lead to a further increase in the capacity of alternative transit routes. Moreover, Ukraine is unable to provide the substantial investment required to modernise the GTS. Kyiv's insistence on a guaranteed loading level for its gas pipeline appears to be the stumbling block in negotiations on a Gazprom-Naftogaz merger. Given the large-scale transport projects that are aimed at reducing the volumes of gas transiting through Ukraine, Gazprom cannot give such guarantees. However, the conflict of interests may possibly be resolved by Gazprom's acquisition of a stake in Naftogaz, following the Ukrainian President's efforts to restructure Naftogaz and prepare the company for initial public offering (IPO). According to Yanukovich, the company is overburdened and does not always function efficiently. He believes its structure should be divided up (Naftogaz incorporates 11 subsidiaries) and the different parts developed individually. Those individual companies should register on world stock exchanges and hold IPOs, he says.

*RBK daily*

## **Ukraine ready to help LUKOIL in launching Odessa Refinery**

*July 18, 2011*

Ukrainian authorities are ready to help Russian oil major LUKOIL re-launch the Odessa Refinery, which has been idle for nine months. Ukraine's First Deputy Prime Minister Andrei Klyuyev instructed the Ministry of Energy and the Coal Industry to hold talks with the management of LUKOIL on launching the refinery operations.

### **Note:**

*Due to current conditions in the Ukrainian market for petroleum products it has become uneconomic to operate the Odessa refinery. LUKOIL has therefore decided to shift the scheduled maintenance at the refinery from the first quarter of 2011 to the fourth quarter of 2010. Oil refining in Ukraine is uneconomic because Ukraine imports large amounts of oil products from Belarus at dumping prices. Kremenchug and Lisichansk refineries are also making losses due to Belarusian imports. Furthermore the Odessa refinery lost its main oil supply route after the Odessa-Brody pipeline switched to transporting Azeri oil to Belarus.*

*RBK daily*

## **Russian-Ukrainian gas conflict nearing resolution**

*September 27, 2011*

The gas conflict between Russia and Ukraine reached its height in late summer 2011. On September 1, Ukraine's Energy Minister announced that from 2012 Ukraine intends to drastically curtail Russian gas purchases to 27 billion m<sup>3</sup> (compared to a planned purchases of 41.6 billion m<sup>3</sup> 2011) and to submit an appeal to the Court of Arbitration in Stockholm to have the gas contract amended.

On September 2, Ukraine resumed negotiations with Gazprom on curtailing gas deliveries. In addition, Kyiv proposed amending gas transit terms for 2012. By September 5 relations between the two countries had deteriorated further. If talks over the current gas contract fail, it is very likely that Ukraine will liquidate its national energy company Naftogaz, which will force a review of gas contracts between Russia and Ukraine.

On September 17, the Ukrainian authorities expressed their readiness to make concessions on Russian gas supplies in the context of Gazprom's legally binding agreement with its partners to build the South Stream pipeline, which bypasses Ukraine. On September 26, Yanukovich visited Moscow to discuss the possible establishment of a gas consortium, and finally the parties reached a truce. Following talks between the Presidents of Russia and Ukraine, also attended by Russian Prime Minister Vladimir Putin, Russia dropped its insistence on Ukraine acceding to the CU and was prepared to discuss a trilateral gas consortium with the EU on the basis of Ukraine's gas transportation system. On September 27,

Ukraine announced new terms for Russian gas deliveries. Kyiv is bringing down the price for gas transit in exchange for gas price discounts for consumers in the public and social sectors. The parties' mutual concessions total \$1.5 billion.

*Kommersant, Expert Online, RBK daily*

## MISCELLANEOUS

### **Russia abolishes duties on exports of oil products to Kyrgyzstan**

*January 21, 2011*

From January 1, 2011, Russia lifted duties on oil products exported to Kyrgyzstan. The verbal agreement followed a meeting between Russian Prime Minister Vladimir Putin and his newly appointed Kyrgyz counterpart, Almazbek Atambayev. Kyrgyzstan and Russia have been in talks on introducing preferential duties on exports since mid 2010. Bishkek was keen to reduce vehicle fuel prices. Light oil products supplied to Kyrgyzstan became liable to customs duties from April 1, 2010, resulting in a price increase of over 30%. Kyrgyzstan hoped to cut the purchase price for oil products from the current \$550-600 to \$400 per tonne.

Russia supplied over 900,000 tonnes of oil products to Kyrgyzstan in 2010, with Gazprom Neft being Russia's primary vendor, accounting for around 500,000 tonnes of the total supplied.

*RBK daily*

### **Belarus ratifies oil transportation agreement with Ukraine**

*April 4, 2011*

Belarus has ratified an intergovernmental agreement with Ukraine on oil transit. According to the Deputy Chairman of Belneftekhim Vladimir Volkov the intergovernmental agreement on cooperation in oil transportation through Ukraine to Belarus, signed in July 2010, was adopted with the aim of diversifying oil supplies to the Republic of Belarus. The agreement allows Belarus to significantly cut the cost of oil transportation by using Ukraine's oil transportation infrastructure. The cost of transporting oil by rail has decreased from \$66 to \$42.5 per tonne, while the cost of transporting oil by pipeline has gone down to \$15 per tonne.

As part of the agreement, Belarus undertakes to import 4 million tonnes of crude oil from Venezuela by April 2011, using Ukraine's oil pipeline and rail transportation system. This figure will increase to 10 million tonnes subsequently.

The agreement sets the tariff for oil transportation through both countries by rail at \$0.27 per tonne per 10 km, which is \$22 per tonne lower than the

previous tariff. Before November 1 the parties are due to agree upon the volume and tariffs of oil transportation through the territory of Ukraine in subsequent years.

*RIA Novosti*

### **LUKOIL to raise funds for projects in Uzbekistan**

*June 7, 2011*

LUKOIL, Russia's largest oil company, intends to raise \$500 million to finance investment in the Kandym and Khauzak-Shady oilfields in Uzbekistan.

The consortium of lenders is expected to include international financial organisations, the Asian Development Bank, the Islamic Development Bank and commercial banks: BNP Paribas (Suisse) SA; Korea Development Bank; Crédit Agricole CIB; and UniCredit Group. The commercial loans will be underwritten by the ADB and the Multilateral Investment Guarantee Agency (MIGA).

The project is still subject to approval from the Republic of Uzbekistan. It is expected that financing will be secured by the third quarter of 2011.

#### **Note:**

*The agreement on the Khauzak-Shady-Kandym project was signed on June 16, 2004. The Khauzak gas field was commissioned in November 2007. Production is estimated to reach 12 billion m<sup>3</sup> of gas per year.*

*Kursiv.kz*

### **KMG interested in joint work with Gazprom Neft**

*June 9, 2011*

KazMunayGaz, Kazakhstan's national oil company, has requested talks with Gazprom Neft on implementing joint projects with Russia. Boris Zilbermints, Gazprom Neft's Deputy General Director for Exploration and Production, said that Gazprom Neft may offer KMG not only its own assets but third party assets as well.

#### **Note:**

*KazMunayGaz, Kazakhstan's National Oil Company, is owned by Samruk-Kazyna National Welfare Fund. Gazprom Neft (formerly Sibneft) is the oil arm of Gazprom, which owns over 95% of Gazprom Neft's shares. As of 2010, Gazprom Neft's consolidated oil production totalled around 52 million tonnes. The company plans to increase its oil production to 100 million tonnes by 2020 under a \$70 billion oil business development strategy.*

*RIA Novosti, Kursiv.kz*

## **Kazakhstan, Russia agree to abolish oil duties**

*July 18, 2011*

Russian President Dmitry Medvedev has signed a federal law “On Ratification of the Agreement between the Government of the Russian Federation and the Government of the Republic of Kazakhstan on Trade and Economic Cooperation in Oil and Oil Product Supplies to the Republic of Kazakhstan”.

The document bans the application of export duties and other similar duties, taxes and levies to oil and oil products traded between the two countries.

According to the new law, the relevant authorities of Russia and Kazakhstan will negotiate to balance output, consumption, supply, imports and exports of oil and oil products in both states. The countries will also coordinate volumes of oil delivered by Russia and Kazakhstan to Belarus, and deliveries of crude oil and derivative products between all three states (indicative balance).

*RBK, Kursiv.kz*

## **Supplies of fuels to Kyrgyzstan to be resumed**

*July 20, 2011*

Kyrgyz Prime Minister Almazbek Atambayev visited Moscow to discuss the resumption of Russian oil product supplies to Kyrgyzstan. Omsk Refinery, the main supplier of Russian fuel to Kyrgyzstan, halted deliveries of high-octane AI-92 and AI-95 gasoline to Kyrgyzstan in early July, forcing many petrol stations to close, which led to panic buying, petrol queues and price hikes of 20-25%.

Experts believe that the petrol crisis has political roots. Should the fuel and lubricant crisis be successfully resolved before the elections on October 30, it will considerably improve Atambayev's chances of winning another term in office.

### **Note:**

*Gazprom Neft Asia, which controls around 90% of gas stations in Kyrgyzstan, made an official statement on July 19, saying that the shortages of high-octane gasoline was a result of Russia's new regulations that tightened quality requirements on goods for Russia's domestic consumption. As a result, Omsk Refinery, which produces Euro-3 standard high-octane petrol, appeared to be overloaded with domestic product while deliveries to other countries suffered. Gazprom Neft Asia secured supplies of high-octane petrol from other Russian refineries, including the Kuibyshev, Salavat and Astrakhan Refineries. The refineries dispatched the petrol in time for a first shipment on July 21.*

*Kommersant-Online*



## **Bishkek may sell its oil and gas industry to Gazprom**

*September 8, 2011*

Gazprom CEO Alexei Miller met with Kyrgyz Prime Minister Almazbek Atambaev to discuss Gazprom's work in Kyrgyzstan. Miller announced that his company plans to spend 3 billion roubles on oil and gas exploration in Kyrgyzstan. Miller indicated that Gazprom and the Kyrgyz government were working out the final details of Gazprom's purchase of majority stakes in Kyrgyzgaz and Kyrgyzneftegaz, which together control almost the entire oil and gas industry in Kyrgyzstan.

Kyrgyzneftegaz is the only Kyrgyz company involved in exploring and developing oil and gas fields, transporting and refining oil and selling oil products. Kyrgyzgaz retails gas to domestic consumers and is involved in the transit of Kazakh and Uzbek gas.

Kyrgyzstan's proven natural gas reserves are very limited and amount to a mere 6 billion m<sup>3</sup>. Investment in exploration has been insignificant up to now, and it is possible that the country's reserves could be substantially higher, experts believe. Rough terrain and poor infrastructure have hindered exploration. Annual average gas production of 30 million m<sup>3</sup> in Kyrgyzstan is significantly below consumption, which amounts to some 750 million m<sup>3</sup>.

*RBK daily*

## **Kazakhstan to supply gas to Kyrgyzstan**

*September 29, 2011*

KazTransGaz is to sell 300 billion m<sup>3</sup> of gas to Kyrgyzgaz as the government of Kazakhstan moves to help its neighbour following Kyrgyzstan's failure to negotiate gas supplies with Uzbekistan. According to the contract, Kazakhstan will sell the gas at a price of \$295 per 1,000 m<sup>3</sup>, which is \$15 per 1,000 m<sup>3</sup> lower than the price offered by Uztransgaz for the fourth quarter of 2011. According to Kyrgyz Energy Minister, Askarbek Shadiyev, Uzbekistan sold gas to Kyrgyzstan for \$278 per 1,000 m<sup>3</sup> in the third quarter of 2011, but raised the price to \$310 in the fourth quarter.

In early 2011 Uzbekistan's actions caused gas shortages in southern Kazakhstan. Reduced gas supplies from Uzbekistan and illegal siphoning off of gas in Kyrgyzstan led to a gas deficit in the southern regions of Kazakhstan. The state managed to make up the shortfall by buying Turkmen gas, delivered through the Turkmenistan-Kazakhstan-China gas pipeline. Potential gas shortages in southern Kazakhstan over winter will be averted by using gas from the Kazakhstan-China trunk line.

*Kursiv.kz*

## Turkmenistan boosts gas deliveries to China

November 24, 2011

China signed an agreement with the Central Asian nation of Turkmenistan to boost its future annual natural gas purchases by 25 billion m<sup>3</sup>. The deal means Turkmenistan's annual gas sales to China will eventually reach 65 billion m<sup>3</sup>, equivalent to more than half China's entire natural gas consumption last year.

The parties did not specify the start date for deliveries of additional volumes of gas. However, gas deliveries will probably not begin before construction of the third Central Asia-China pipeline is completed. The pipeline has a capacity of 60 billion m<sup>3</sup> of gas per year, and is due on stream in late 2015. Turkmenistan currently exports just over 12 billion m<sup>3</sup> of gas to China annually (based on January-October figures).

A new agreement with Turkmenistan may once again complicate the negotiations between China and Russia's Gazprom, which have been dragging on for several years without any successful outcome.

### Note:

*Until recently Russia was the principle buyer of Turkmen gas. However, relations between the two states were strained after an accident on the Central Asia-Centre-4 (CAC-4) gas pipeline in Turkmenistan in April 2009. Although the pipeline was repaired, deliveries of Turkmen gas to Russia were not resumed. Russia began importing again only in early 2010, lifting 10 billion m<sup>3</sup> of Turkmen gas per year, down 80% from the pre-accident level (50 billion m<sup>3</sup> annually). Turkmenistan had to search for other markets. According to the Bank of Moscow, Turkmenistan exported 21 billion m<sup>3</sup> of gas in 2010, including 10 billion m<sup>3</sup> to Russia, 7 billion m<sup>3</sup> to Iran and 4 billion m<sup>3</sup> to China.*

*RBK daily*

## ENERGY

### Kazakhstan ratifies Kazakh-Russian agreement on construction of third unit of Ekibastuz GRES-2

January 17, 2011

The President of Kazakhstan Nursultan Nazarbayev signed the law "On Ratification of the Agreement between the Government of the Republic of Kazakhstan and the Government of the Russian Federation on Construction and Operation of the Third Power Unit of the Ekibastuz GRES-2 Power Plant". The agreement was signed in July 2010. Project costs are estimated at \$700 million.

At present the installed capacity of Ekibastuz GRES-2 is 1,000 MW with its two power units accounting for 12% of all electricity produced in Kazakhstan. The construction of the third power unit will increase the installed capacity of the

power plant by 50%. Ekibastuz GRES-2 Station JSC is owned jointly by Russian and Kazakh shareholders (half each by Inter RAO UES and Samruk-Kazyna).

The two countries also signed an agreement on integration and cooperation on the peaceful use of nuclear energy and a Joint Statement by Rosatom, Russia's State Nuclear Energy Corporation, and Kazatomprom, Kazakhstan's National Atomic Company.

*IA Novosti-Kazakhstan*

### **Russia to invest in Afghanistan's electricity system**

*January 21, 2011*

Russia's state-controlled energy trader Inter RAO is to invest \$500 million in a project to supply electricity to Afghanistan, Prime Minister Vladimir Putin said during a meeting with Afghan leader Hamid Karzai. The \$680 million CASA-1000 project involves the construction of power transmission lines from Kyrgyzstan and Tajikistan to Afghanistan and Pakistan.

Putin said that if Inter RAO bid successfully to be the project's operator, the Russian company could take an active part in the construction of high-voltage electric power lines as part of the CASA-1000 project, bringing Russian investment to a total of \$500 million.

*Finam.ru*

### **Nuclear integration**

*April 4, 2011*

Russia and Kazakhstan have signed an agreement on the peaceful use of nuclear energy, which foresees inter alia the construction of a nuclear power plant in Aktau, the first two reactors of which would be commissioned in 2016.

One of the flagship joint projects is a new uranium enrichment centre at the Uralsk Electrochemical Plant. Back in 2007 Russia and Kazakhstan had agreed to construct the International Uranium Enrichment Centre (IUEC) on the basis of the Angarsk Electrolysis Chemical Complex. The IUEC is currently engaged in storing enriched uranium. In the longer term it will also recycle spent fuel from abroad. However, during the EurAsEC summit in 2010 in Astana Russian atomic specialists put forward an alternative proposal for another uranium enrichment centre (UEC) at the Uralsk Electrochemical Plant in Novouralsk.

Russia and Kazakhstan will have an equal stake in the project. Rosatom's subsidiary, TVEL Fuel Company, purchased 50% of shares in UEC on March 25. The remaining 50% is owned by Kazatomprom. The parties have not yet disclosed any information about the cost of Kazakhstan's share in the joint venture, the date construction will begin or the investment required.

Kazatomprom has become one of the leading uranium handling companies; however it is unable to perform the enrichment stage of the nuclear fuel cycle. Under certain agreements with Russia, Kazakhstan may become a co-owner of Novouralsk Chemical Plant, gaining access to a guaranteed share of its production and the right to use the plant as it requires. In return Russia will receive a 50% stake in several companies in Southern Kazakhstan, giving the country access to Kazakh raw materials.

*Expert Kazakhstan, Expert*

### **Inter RAO resumes electricity supplies to Belarus**

*July 4, 2011*

Russia's electricity supplier Inter RAO UES has resumed electricity supplies to Belarus after the latter transferred the third and final tranche of its debt in the amount of 611 million roubles. The second tranche of debt was repaid on June 29. Belarus borrowed from BPS-Bank (a subsidiary of Sberbank) to repay its debts for Russian electricity amounting to a total of 1.5 billion roubles.

#### *Chronology of conflict:*

*Inter RAO UES first announced that Belarus had run into debt for electricity on June 8, 2011. Russia's electricity supplier warned that it would halt deliveries; however the parties managed to negotiate a delay in payment until July 5. The debt was to be repaid in several tranches. The first tranche of 600 million roubles was transferred within the period stipulated. However, Belarus failed to make the second payment by the June 20 deadline, and Inter RAO UES threatened to discontinue electricity deliveries on June 22. Following talks, the parties agreed to postpone the second payment for another week. However, Belarus once again defaulted and power supplies were cut off on June 29, leading to another crisis in relations between Russia and Belarus.*

*Unlike gas supply disruptions, power cuts are not critical for Belarus since it produces enough electricity power to cover 90% of its domestic consumption and imports the remaining 10%. Because Belarus uses Russian gas to produce electricity, the cost of domestically produced energy is 30% higher than that of imported power. HPPs produce a small proportion of the country's energy, and a nuclear power plant is currently in the design phase. At present Belarus is working on importing electricity from Ukraine. Minsk has tried to reach an agreement with Gazprom on freezing gas prices in 2011 and anticipates a price cut in 2012. Belarus is keen to secure pricing identical to Russia's domestic tariff, since Russia and Belarus will be part of the Single Economic Space from January 2012. But prices for Belarus are currently more than twice as high: in the second quarter of 2011 Belarus was paying \$245 per 1,000 m<sup>3</sup> of gas and prices are about to rise to \$300-\$305 per 1,000 m<sup>3</sup> by year end. Smolensk region, Belarus' reference point, buys gas for \$106-\$117 per 1,000 m<sup>3</sup>. The conflict continues to escalate. On July 1 Belarus tried to raise tariffs for the transit of oil products by 15.9% to \$1.9 per tonne per 100 km. The decision was approved by Belarusian Energy Ministry. However, the head of Gazprom stated that "price conditions of the operating contract for gas deliveries are not liable to variation". According to experts, Moscow is acting tactically to force Minsk to sell the remaining part of Beltransgaz, the operator of its national gas transportation system.*

*Kommersant, RBK daily, Expert*

## Belarus

### Moscow, Minsk resume energy cooperation

*January 25, 2011*

Rosatom chief Sergei Kiriienko met with Belarusian Prime Minister Mikhail Myasnikovich to plan the timetable for drafting agreements on the construction of Belarus Nuclear Power Plant and a methodology for costing the project. The parties plan to sign intergovernmental agreements on the NPP and parallel operation of power grids in February-March 2011. A master contract for the NPP construction will be signed by September. The first reactor is due to be commissioned by 2017. According to Kiriienko, the cost of the dual reactor NPP with a total capacity of 2.4 GW should amount to \$6-7 billion, or \$2,500-2,900 per kW of installed capacity.

Moscow and Minsk have been in talks since 2009 on constructing the first nuclear power plant in Belarus. Negotiations focused on the amount that Russia would lend for the project and on creating a joint venture to sell the electricity produced. Minsk insisted that Russia should finance the construction of the NPP and its infrastructure, and requested a total of around \$9 billion. In August 2010, when the foundations of the joint venture were in place, Belarus suddenly pulled out of establishing the company. Now the parties have agreed credit terms and the loan agreement may be signed in June 2011.

A joint venture between Belenergo and Inter RAO UES will sell and distribute power. Both sides signed the agreement necessary to operate their power grids in parallel. The agreement states that electricity produced by the first reactor of the Belarus NPP will be directed to the Belarusian domestic market, while the second unit will produce for export. Resolving the issues relating to the NPP and sales of its output has helped to ease tension in energy relations between Russia and Belarus. Moreover, the agreement specifies the resumption of interstate cross-flows, which were halted by Belarus in early 2010.

*Kommersant*

### Belarus NPP construction faces difficulties

*June 29, 2011*

The licence to construct a Russian-designed nuclear power plant in the Grodno region of Belarus should be granted by October 2011, head of the Belarusian Energy Ministry's Nuclear Energy Department Nikolai Grusha said. He added that Belarus would go ahead with excavating ground for the foundations of the NPP in the fourth quarter of 2011 despite the temporary lack of a licence. The senior managers of Atomenergoproekt (a member of the Rosatom group of companies), the lead design company for the Belarus NPP, announced that the initial construction work (i.e., the plant's foundations)

would begin in autumn 2012, after the technical design had been approved and a construction licence issued. The design of the Belarus NPP is identical to nuclear power plants being built in the Leningrad and Kaliningrad regions of Russia, except for the water supply system.

Despite stiff opposition from neighbouring Lithuania and occasional disagreements between Russia and Belarus on economic issues, preparations for the construction of the Belarus NPP, which will reduce Belarusian consumption of Russian gas by 25%, are under way. Belarus has simultaneously proposed cooperation with the Republic of Korea in the field of nuclear energy. Belarus is keen to train nuclear power specialists, and to share Korean technology for constructing and maintaining nuclear power plants, and protecting personnel from radiation exposure.

#### Note:

*The proposal to build a nuclear plant in Belarus was made by the country's President Alexander Lukashenko in April 2007 when his country was facing the inevitable rise in prices for Russian gas (95% of Belarusian power plants are gas-fired) and Lithuania's plans to decommission the Ignalina Nuclear Power Plant, its largest source of electricity, in late 2009. At the time it was decided that the first Belarusian nuclear power station would be constructed by Russia's Atomstroyexport (part of the Rosatom State Corporation and a leading engineering company with expertise in constructing nuclear power facilities abroad). In addition, Russia was to supply fuel to the power plant for its whole lifetime, evacuate the plant's nuclear waste back to Russian territory, and provide a loan of \$7 billion for its construction. Belarusian contractors were to do most of the construction work. In return Belarus agreed to trade in the electricity output of the NPP jointly with Russia. Russia pledged to grant Belarus a loan for building the two NPP reactor units of Russian AES-2006 design with a total capacity of 2.4 GW. The reactors may be commissioned in 2016-2018.*

Expert Online

## Ukraine

### Russia, Ukraine agree upon joint nuclear fuel production

February 3, 2011

In late January the Ukrainian state-run Nuclear Fuel group of companies and TVEL Fuel Company of Russia drafted a joint venture agreement to produce nuclear fuel for Ukrainian nuclear power plants.

In autumn 2010 TVEL won a tender to build a nuclear fuel plant and signed the agreement on October 27, giving TVEL a 50% minus one share in the joint venture, while Ukrainian Nuclear Fuel will retain the controlling stake. The parties have also resumed technical and economic feasibility studies for the plant, which were suspended after the administration of the then President of Ukraine Viktor Yushchenko switched to partner with Westinghouse. Rosatom and TVEL worked very hard to negotiate the construction of a nuclear fuel plant and long-term fuel supply contracts for the country's four nuclear power

stations (15 reactors of Soviet designed VVER type) before the current Ukrainian President Viktor Yanukovich came to power.

The parties have not specified any date for signing the agreement and starting construction. It was announced earlier that the plant could start operating in 2012. However, even the location of the plant is still unclear. Ukraine is currently considering four sites, including the Eastern Mining and Processing Integrated Works and Pridneprovsk chemical plant in the Dnepropetrovsk region, and sites in the Sumy region.

*Kommersant*

### **Ukraine may rival Russia in nuclear fuel production**

*September 15, 2011*

Ukraine's state-run Nuclear Fuel group and Russia's TVEL Fuel Company (part of Rosatom) have established a joint venture to construct a nuclear fuel plant in Ukraine's Kirovograd region. The plant will supply fuel to Ukrainian nuclear power stations. The controlling interest in the joint venture belongs to Ukraine. Four Ukrainian nuclear power plants (Zaporozhye, South Ukraine, Rovno and Khmelnytsky) are the largest foreign consumers of nuclear fuel produced by Rosatom. In 2010 TVEL supplied nuclear fuel to Ukraine's Energoatom National Nuclear Energy Generating Company for a total \$608.1 million. As tensions between Russia and Ukraine eased, the states agreed that Russia would build the two new reactor units at Khmelnytsky NPP to cover the shortfall in generating capacity in the western regions of Ukraine. Russia will also grant a discount on the nuclear fuel price. It was also agreed that Russia would build a facility to help Ukraine develop full nuclear fuel cycle technologies, by licensing such technologies on a non-exclusive basis. There were also commitments from Russia to provide uranium enrichment services on a long-term basis and on favourable commercial terms. At the same time Ukraine is continuing to support Rosatom's rival, Westinghouse, in its efforts to expand its business in the country. Under President Viktor Yushchenko Westinghouse signed an agreement with Energoatom on nuclear fuel supplies to the three reactors of the South Ukraine NPP in 2011-2015 with the prospect of supplying a further six reactors at other Ukrainian NPPs. These deals put Russia in a tricky situation. On the one hand, TVEL and Nuclear Fuel had made joint statements that the construction of a \$370 million nuclear fuel production plant based on Russian technology was under way. Meanwhile, in early September Westinghouse's fuel had already been delivered to the second reactor at the South Ukraine NPP and may be supplied to the Zaporozhye NPP by year-end. Moreover, in August the Ukrainian Energy Ministry published a draft Nuclear Code which states that, for energy security purposes, Ukraine should purchase nuclear fuel from two or more sources, while draft amendments to the Energy Strategy for Ukraine to 2030 suggest legislating for at least two nuclear fuel plants constructed by

different engineering companies. According to Nuclear Fuel General Director Tatiana Amosova, the Russian-Ukrainian plant will not only cover Ukraine's nuclear fuel requirements but will also allow Ukraine to export one third of the fuel it produces. So whilst Russia and Ukraine are due to commence construction of a nuclear plant in Ukraine and begin licensing nuclear fuel cycle technologies, Ukraine appears to be giving assurances to Russia whilst looking towards America and possibly considering a Chinese nuclear fuel supply. Thus, by building a nuclear fuel plant in Ukraine, Rosatom risks creating a rival for itself that will start selling nuclear fuel at dumping prices to other players which the Russian nuclear giant traditionally supplies.

*Expert Online*

## FINANCE

### **Sberbank expands its activity in Kazakhstan**

*May 19, 2011*

The Kazakh subsidiary of Russia's Sberbank plans to be among the top three lending institutions in the country, Sberbank's president German Gref said at the Foreign Investors' Council on May 18 in Astana. Sberbank's Kazakh arm plans to issue bonds totalling 100 billion tenge (\$684 million) by the end of 2012. Currently Sberbank ranks ninth among Kazakhstan's 39 banks in terms of assets.

During his visit to Astana Gref underlined that Kazakhstan remains an important market for Sberbank.

Earlier Sberbank said that the bank's growth in Kazakhstan may involve the acquisition of the local BTA Bank. The final decision on this is still to be taken.

#### **Note:**

*Samruk-Kazyna National Welfare Fund currently owns an 81% stake in BTA Bank.*

*RBK daily*

### **Development Bank of Kazakhstan, Vnesheconombank sign credit agreement**

*June 15, 2011*

Within the framework of the SCO Interbank Consortium Council meeting, the Development Bank of Kazakhstan and Russia's Vnesheconombank signed an Addendum opening a \$300 million credit facility to the Agreement on the General Terms of Opening a Credit Line concluded on September 22, 2008.

The parties intend to continue financing projects that will ultimately supply Russian products, including industrial goods, and services, to Kazakhstan.



Implementation of the agreements will help promote Russian industrial exports, enhance economic ties between Russia and Kazakhstan, and expand the use of Russian currency in servicing and funding foreign economic activity.

*Kursiv.kz*

### **VTB Kazakhstan granted membership of KASE**

*July 1, 2011*

The Kazakhstan Stock Exchange Board of Directors admitted VTB Kazakhstan, the subsidiary of Russian state-owned VTB Bank, as a member of KASE foreign exchange market on June 30, 2011. The bank is now entitled to engage in trading at KASE.

VTB opened in Kazakhstan and has been offering a range of banking services to corporate and private clients since May 2009.

*Kursiv.kz*

### **New participant on Kazakhstan's banking market**

*August 4, 2011*

Promsvyazbank, one of Russia's ten largest banks by assets, is considering opening a representative office in Kazakhstan. Promsvyazbank vice president Anna Belyaeva expressed the hope that Kazakhstan's banking market would be a lucrative target for the bank's foreign expansion and noted that the market in Kazakhstan is one of the most important in the CIS. For ten years, Promsvyazbank has been successfully developing interbank cooperation in the region, servicing trade flows between Russia and Kazakhstan.

*Kursiv.kz*

### **Belaruskali to hold IPO**

*June 30, 2011*

Belarus will hold an initial public offering for the potash mining company Belaruskali which accounts for around 15% of global potash fertilizer production, First Deputy Prime Minister Vladimir Semashko announced. Belarus is prepared to place 10-15% of the shares in Belaruskali, Semashko announced. The company is currently 100% state-owned. However, the estimated IPO date and the stock value were not disclosed.

In June 2011 the President of Belarus Alexander Lukashenko valued Belaruskali at \$30 billion. Previously, the Belarusian authorities had planned to sell up to 25% in Belaruskali for \$6-7 billion. Sources subsequently revealed that the possible sale of a controlling stake in Belaruskali to Nafta Moskva investment

group for \$15 billion was being planned. However, Uralkali, the Russian potash giant, was later thought to be the most likely buyer of Belaruskali. Nevertheless, Uralkali's Director General Vladislav Baumgertner stated that although the acquisition of Belaruskali was of interest, it was highly unlikely a deal will be closed in the short term.

*Reuter*

### **Belaruskali raises credit**

*August 15, 2011*

Russia's Sberbank and Deutsche Bank AG agreed to lend \$2.3 billion to Belarusian potash mining company Belaruskali. The loan will be secured against export contracts and a 35% stake in the company as collateral. Belaruskali's annual revenues amount to around \$3 billion, and according to analysts the 35% stake is worth around \$5 billion, therefore the collateral would appear viable without the need to account for political risk.

Russia has considered different ways of helping Belarus tackle its financial crisis and dwindling gold and foreign currency reserves. Credit financing in partnership with western banks minimises political risk. The 35% collateral stake in Belaruskali would prevent Belarus selling those shares to companies in Asian countries which, as major consumers of potash fertilizers, are interested in securing stable deliveries and low prices.

*Expert, RBK daily*

### **Belarus offers 51% of Naftan as loan collateral**

*September 21, 2011*

The Belarusian government and Sberbank of Russia are continuing to negotiate a \$1 billion loan to Belarus, which is prepared to offer government guarantees and 51% of Naftan Refinery shares as collateral, Deputy Prime Minister of Belarus Sergei Rumas said at a press conference in Minsk. Belarus did not want to pledge the shares of Belaruskali, one of its most successful companies, Rumas said, therefore an agreement was reached with Sberbank that the loan would be secured by a government guarantee and shares of another enterprise as collateral.

#### **Note:**

*Belarus had earlier rejected a \$2 billion loan from Sberbank and Deutsche Bank on terms offered by the Russian bank including 35% of Belaruskali as collateral.*

*Expert Online*

## TRANSPORT AND LOGISTICS

### **Russia enters Kazakhstan's terminal operations and cargo handling market**

*April 11, 2011*

In mid March TransContainer, the Russian intermodal freight operator, acquired a 67% stake in JSC KedenTransService, a leading private cargo handling operator in Kazakhstan. KedenTransService operates 17 cargo handling terminals across Kazakhstan and owns a fleet of freight locomotives. Kazakhstan Temir Zholy (KTZh), the Kazakh state-owned railway company, will retain a 33% stake in KedenTransService.

The new business will bring cargo handling infrastructure and facilities under one banner, offering door-to-door cargo delivery services. Russia had considered the possibility of entering Kazakhstan's terminal operations and cargo handling market in May 2009, when Russian Railways and KTZh signed a memorandum of cooperation.

The Kazakh government is aiming to develop railway infrastructure to boost the region's transit potential (for example, through the construction of the Western China-Western Europe International Transit Corridor, development of the Khorgos International Centre for Boundary Cooperation, construction of the Khorgos-Zhetysay railway and active use of a new Shar-Ust-Kamenogorsk railway line).

Penetrating Kazakhstan's market is part of a long-term plan by RZD, which, in late 2010, signed a package of documents in Beijing establishing a joint Russian-Chinese venture for railway container traffic.

RZD is simultaneously working on expanding its presence in Europe (for example, laying the 1,520 mm broad-gauge railway line to Vienna; entering the terminal operations market in Slovakia and, in the long term, Hungary, to develop container traffic between Russia and the Adriatic ports). Russia is also pursuing its goal of creating a transport corridor between the Asia-Pacific region and Europe, and Kazakhstan fits neatly into this global scheme.

Analysts predict cooperation between RZD and KTZh in cargo handling could eventually lead to the creation of a single company to manage the railway infrastructure of Russia and Kazakhstan. Another view is that the carriers' cross-penetration in neighbouring infrastructure will be pursued as part of the CU; however, under current conditions, it would be almost impossible to unite rail infrastructure of both countries.

*Expert Kazakhstan*

## **Kazakhstan, Russia establish joint venture for grain transportation**

*June 1, 2011*

Rusagrotrans, Russia's largest transporter of grain by rail, and Kaztemirtrans (a subsidiary of Kazakhstan Temir Zholy) have signed a joint venture agreement on grain transportation. The agreement was signed on June 1 in Sochi, during the Strategic Partnership-1520 railway business forum. The venture will be one of the largest logistics and transport projects implemented in the CU.

Kazakhstan, a major grain producer and wheat exporter, faces an acute railcar fleet shortage. Current demand for railcars peaks at around 8,700, whereas Kaztemirtrans has only 5,200 cars at its disposal, which stand idle during less busy times. However, during the off-peak period, the grain cars could be used for transporting goods between Russia and Kazakhstan. The joint venture agreement targets a fleet of up to 10,000 grain cars. It will be established as a 50:50 partnership with a capitalisation of \$90 million. Part of the JV's registered capital will be paid up in the form of railcars.

Kazakhstan is one of the world's largest wheat exporters (according to the US Agriculture Ministry, the country produced around 17 million tonnes and exported 7.87 million tonnes of wheat in 2009-2010); however the lack of grain cars limits the country's export potential. By creating a joint venture exporters of Russian grain will gain an additional opportunity to enter Asian markets using Kazakhstan as a transit route.

*Vedomosti, Kursiv.kz*

## **KTZh, VGK agree on freight-car circulation in Kazakhstan**

*September 27, 2011*

Russia's Second Freight Company (VGK) and Kazakhstan Temir Zholy have agreed that VGK's freight cars may now be used within Kazakhstan. The parties agreed that all VGK freight wagons listed in the automated fleet registration inventory system, which are leased out and circulate abroad, will be subject to unified tariffs and must carry all relevant documents of carriage when entering and travelling through Kazakhstan.

### **Note:**

*Russian Railways established the Second Freight Company (VGK) rail business in 2010. As of late 2011, the company's total railcar fleet is around 180,000 wagons. VGK provides transport logistics and other services.*

*RIA Novosti, Kursiv.kz*

## MACHINE BUILDING INDUSTRY

### Kazakhstan, RUSAL to create joint venture to produce railcars

June 10, 2011

Kazakh President Nursultan Nazarbayev has met with RUSAL CEO Oleg Deripaska. The parties discussed the signing of a letter of intent to create a joint venture to produce railcars. The parties agreed to launch an assembly line within 18 months of signing the letter of intent, and a full production cycle in the longer term. According to Deripaska, Russia and Kazakhstan have decided to upgrade facilities in order to increase production capacity by 20%. The parties have also introduced new technologies to reduce emissions from coal burning by around 40 times. Deripaska also briefed Nazarbayev on the performance of the Samruk Energy-RUSAL joint venture at the Bogatyr coal mine.

#### Note:

*RUSAL is Russia's largest aluminium producer and the world's second largest producer of aluminium and aluminium oxide (as of 2009). The company was established in 2007. RUSAL's total capacities are 4.4 million tonnes of aluminium and 12.3 million tonnes of aluminium oxide per year.*

Kursiv.kz

### Kostanay launches UAZ production project

June 10, 2011

A new plant to manufacture UAZ automobiles has been launched in Kostanay. The first 9,000 cars may be produced by 2015.

The plant is owned by the Sary-Arka Automotive Industry joint venture between Sollers of Russia and Kazakhstan's Tobol Social and Entrepreneurial Corporation.

The project to mass-produce UAZ branded motor vehicles will cost \$2.4 billion. Tobol is allocating 210 million tenge (around \$1.4 million) from its own resources. It was initially thought that the Kazakh government would assist with financing, but this is yet undecided, slowing down implementation of the project.

Kursiv.kz

### Ukrainian and Russian air companies resume merger talks

November 7, 2011

Ukraine's largest aircraft manufacturer, ANTONOV, is seeking joint-venture partners to produce AN-148 and AN-158 aircraft. The joint venture may include Voronezh Aircraft Company (VASO, Russia) and Russian financial institutions.

Russia decided to consolidate aircraft manufacturing assets in 2010, but the merger was impossible at the time because the Ukrainian assets are state-owned, and their corporatisation would take at least two years. The two parties currently own a joint venture, which coordinates the production, marketing and sale of aircraft but they have not transferred assets to the joint venture.

According to ANTONOV officials, the aircraft manufacturing concern does not have the resources necessary to independently develop mass production of AN-148 and AN-158 aircraft. Ukraine and Russia have not yet met their declared target of producing 12 and 24 AN-148 aircraft per year respectively.

Experts believe that an aircraft manufacturing joint venture will face fewer difficulties in attracting funds. Nevertheless Ukrainian analysts expressed concern that, given its superior production capacity, Russia is primarily interested in Ukrainian technologies. As a result, some ANTONOV assets may remain unsold. A complete integration of air companies is more profitable to Ukraine.

*Kommersant Ukraine*

### **AvtoVAZ to build assembly plant in Kazakhstan**

*November 11, 2011*

AvtoVAZ, Russia's largest car maker, has announced plans to build a \$500 million assembly plant in Kazakhstan in 2015. The plant will focus on production of the next generation of Lada cars, as well as two models built on Renault-Nissan global platforms. The new plant will have a capacity of 120,000 cars per year and will be located in the East Kazakhstan region of the country.

AvtoVAZ signed a memorandum on strategic cooperation with Kazakhstan's ASIA AUTO car assembly plant and Yertis Social and Entrepreneurial Corporation on November 10, 2011. The memorandum foresees the establishment of a full-cycle car production plant, including welding and assembly lines, and the production of components.

The first assembly line producing 90,000 cars per year is due to be completed in 2015, and the second line in 2017. According to Kazakhstan's Ministry of Industry and New Technologies, AvtoVAZ and Yertis will each take a 25% plus one share in the joint venture, while ASIA AUTO will be entitled to 50% minus two shares. The Kazakh authorities have provided land for the plant and have promised to build infrastructure for the site.

The Kazakh-assembled cars will be sold in Central Asia, the Caucasus, Siberia and the Far East region of Russia.

*RBK daily, Vedomosti, Finam.ru*

## **Kazakhstan develops light aviation**

*November 25, 2011*

A new aircraft manufacturing plant, KazAviaSpektr, has been established in the Karaganda region of Kazakhstan. The plant will produce light aircraft under licence from Russia's MVEN. The total cost of the project amounted to 1.648 billion tenge (349 million roubles or around \$11.2 million). In exchange for granting a licence, MVEN was given a 10% stake in the new plant. KazAviaSpektr will produce light aircraft, including Farmer-2 and Farmer-500 aircraft used for treating agricultural land with chemicals. The plant will reach its initial estimated capacity of 36 Farmer aircraft per year in 2012.

The Kazakh government will become the plant's major customer. At present 80% of Kazakhstan's aircraft park consists of Soviet-era planes, which are obsolete.

KazAviaSpektr is Kazakhstan's first aircraft manufacturing plant.

*Vedomosti*

## **Kazakhstan's plant to produce Kazan aircraft**

*December 28, 2011*

Kazakhstan's first aircraft manufacturing plant will make 12 Farmer-2 agricultural aircraft, designed by Russia's MVEL (Kazan), in 2012.

Plans to build Farmer agricultural aircraft were included in Kazakhstan's Industrialisation Map and therefore the project received state support. The project helped create 125 new jobs. Initially the factory will assemble aircraft from kits. It also has facilities for moulding polymer composite components. Initially some parts and plane units will be supplied from Kazan. However, the Kazakh plant will eventually be able to produce the entire aircraft, with a capacity of around 50 planes per year. Kazakhstan's demand for Farmer aircraft is estimated at approximately 500 planes; the plant has already received its first 100 confirmed orders.

*Kursiv*

## **COMMUNICATION**

### **Belarus sells stake in MTS JV**

*September 7, 2011*

The State Property Committee of Belarus has announced an auction to sell the Belarusian government's 51% stake in mobile operator MTS Belarus. The auction has been scheduled for December 1, 2011. Bids are being accepted until November 15, 2011. In July, the State Property Committee Chairman

Georgy Kuznetsov said the Belarusian government valued the 51% stake in MTS Belarus at \$960-970 million.

**Note:**

*The Belarusian-Russian limited liability company Mobile TeleSystems (MTS) has been providing GSM 900/1800 mobile communication services in Belarus since 2002. UMTS-based services have been available since 2010. The founders are the Belarusian landline communication monopoly Beltelecom (51% of MTS's registered capital) and the Russian mobile company Mobile TeleSystems (49%).*

*Expert Online*

## **OTHER SECTORS**

### **Kazakh-Russian space cooperation**

*January 17, 2011*

Kazakh President Nursultan Nazarbayev has signed into law the ratification of the Russian-Kazakh intergovernmental agreement on cooperation in space research and the use of space for peaceful purposes, which was signed on May 22, 2008.

The agreement aims to create the necessary legislation and institutions to support mutually beneficial cooperation in the exploration and use of outer space. It regulates the partners' use of intellectual property, confidential information, export controls and customs regulations. It also provides for tax breaks and preferential trade partnerships on goods from countries that are not party to the Customs Union of Russia, Belarus and Kazakhstan.

The implementation of the agreement will facilitate joint space projects, the application of joint research and development work, and, consequently, the creation of a space industry in Kazakhstan. Russia and Kazakhstan will work together in Earth remote sensing; the development of spacecraft, launch vehicles and other equipment; the creation of ground-based space infrastructure; and in other spheres.

*IA Novosti-Kazakhstan*

### **Kazakhstan signs KazSat-3 agreement with Russia**

*June 21, 2011*

Kazakhstan's National Space Agency (Kazkosmos) and Russia's Reshetnev Information Satellite Systems (ISS) have signed a deal to build the KazSat-3 telecommunication satellite.

ISS announced that it had contracted Thales Alenia Space, the European leader in satellite systems, to supply the KazSat-3 communications payload. The satellite will be based on the Express-1000N platform developed by ISS and



will be integrated and tested in ISS' premises at Zheleznogorsk, Russia. The satellite is expected to be ready for service within 2.5 years and will have a 15-year service life and provide TV, radio, and broadband internet services.

Thales Alenia Space and ISS began jointly marketing satellites based on ISS' Express-1000 platform in the early 2000s. Combining ISS' and Thales Alenia Space's products and skills to serve the Kazakh market emulates other important international projects, e.g., Amos-5 (an Israeli satellite) and Telkom-3 (Indonesia).

*Kursiv.kz*

### **KazSat-2 launched**

*July 16, 2011*

Russia's Proton-M booster rocket with a Breeze-M upper stage carrying a KazSat-2 geostationary communications and broadcasting satellite was launched from Baikonur on July 16, 2011.

The KazSat-2 satellite was placed into geosynchronous orbit at 86.5 degrees east longitude. The satellite has 16 active transponders; four of them will provide continuous TV broadcasting and the remaining 12 Ku-band transponders will handle fixed communications. Its launch mass was 1,330 kg, and its expected lifetime is 12.5 years. The contract to build the second KazSat-2 national satellite was signed in 2006 by the Kazakh Republican Space Communication Centre and the Khrunichev State Research and Production Space Centre. French company EADS-Astrum developed the satellite control system.

*Kursiv.kz*

### **Pharmstandard acquires 55% stake in Ukraine's Biolek**

*January 19, 2011*

Leading Russian pharmaceutical company JSC Pharmstandard has announced the acquisition of 55% stake in the Ukrainian company Biolek. The move followed the Ukrainian Antimonopoly Committee's decision in November 2010 to grant permission for the purchase of over 50% of the shares of Biolek. The deal was financed from Pharmstandard's own funds.

Biolek, one of Ukraine's top-20 pharmaceutical companies, produces immunobiological products, vaccines, serums, diagnostics products, culture mediums and blood products, as well as hormonal, antiviral, antibacterial and enzymatic agents.

According to unaudited data, Biolek's sales reached \$13.3 million in 2009, while 2010 projected sales will reach \$17.7 million (a 23.3% increase year-on-year). Exports account for 23% and domestic sales for 77% of the company's revenue.

Pharmstandard Director General Igor Krylov noted that Biolek is the company's first acquisition in Ukraine. The Ukrainian market is the second largest after Russia in terms of sales volume. Pharmstandard's current product range will be diversified with vaccines and serums, oncological and immunobiological drugs. Biolek's products are largely sold in Russia; Pharmstandard plans to increase sales on the Russian and overseas markets.

*Finam.ru*

### **RUSAL may stop aluminium production in Ukraine**

*April 11, 2011*

Due to unresolved electricity pricing issues, RUSAL may disable all electrolysis units at the Zaporozhye Aluminium Plant, leaving only the foundry division functioning. RUSAL has long been trying to negotiate differentiated electricity tariffs for the plant. Due to the high cost of electricity, aluminium production at Zaporozhye Plant is unprofitable. In order to reduce losses to breakeven point RUSAL had to raise its prices in March. However, this made its products uncompetitive, and stocks began to accumulate, leading to a gradual shutdown of the plant's electrolysis units.

#### **Note:**

*RUSAL, one of the world's leading aluminium producers, accounts for around 10% of both the global aluminium market and the global aluminium oxide market. The company operates in 19 countries and exports its products mainly to Europe, North America, South East Asia, Japan and Korea.*

*RIA Novosti*

## **AGRICULTURE**

### **Russia halts milk powder exports from Belarus**

*May 19, 2011*

Russia has limited shipments of milk whey and milk powder from Belarus, but has placed no restrictions on the supply of butter and cheese. In late 2010 the agriculture ministries of both countries signed a food balance for 2011, defining the precise amount of mutual supplies of foodstuffs. According to the document, Belarus would supply to Russia 65,000 tonnes of skimmed milk powder (compared to 32,000 tonnes in 2010), 20,000 tonnes of whole milk powder (12,000 tonnes in 2010), 50,000 tonnes of concentrated milk (40,000 tonnes in 2010), 70,000 tonnes of butter (50,000 tonnes in 2010), 125,000 tonnes of cheese and cottage cheese (116,000 tonnes in 2010).

Belarus suspended deliveries of milk whey and milk powder to the Russian market from May 18, 2011. Belarus is abiding by the commitments it made under a dehydrated milk agreement with Russia, and does not export such

products to Russia so as not to harm the interests of Russian farmers, Russian Minister of Agriculture Elena Skrynnik said.

**Note:**

*The current tensions between the two countries came as no surprise to the market since they arise every year during the "big milk" period. In June 2009 the Federal Service on Customers' Rights Protection and Human Well-being Surveillance (Rospotrebnadzor) banned exports of 1,500 types of Belarusian dairy products to Russia. Belarus responded by introducing partial customs controls at its border with Russia. The "Milk War" was brought to an end after the two governments agreed technical terms and the volume of dairy imports into Russia. In mid May 2010 supplies of powdered milk from Belarus were stopped again until July. This year, due to the macroeconomic situation, the Belarusian Agriculture Ministry is taking a tougher stance in negotiations. The Belarusian rouble has been devalued, the country needs currency, and dairy products are the country's major export commodities.*

*RBK daily, Kommersant*

**Kazakhstan squeezes Russian grain traders**

*October 3, 2011*

Russian grain exports have reached a record high of more than 9 million tonnes in just three months. To maintain the flow of exports, the Russian government is ready to reduce the tariff on transporting grain by rail to seaports. However, further expansion of Russian grain exports may be hampered by Kazakhstan, which is expecting a record grain harvest this year. Last week, for example, Egypt purchased 120,000 tonnes of grain from Russia and another 120,000 tonnes from Kazakhstan. The Kazakh government is subsidising rail transportation via Russia to the Mediterranean markets. The number of grain carriers is expected to double as Russian transport companies lease further rolling stock. According to the Kazakh Minister of Transport and Communications, Berik Kamaliyev, Kazakhstan Temir Zholy, the state-owned railway company, agreed to lease 5,500 Russian grain cars, including 4,000 grain carriers from Rusagrotrans, 1,000 cars from Tekhnotrans, and 500 cars from Baltic Grain House.

*RBK daily*

**MILITARY AND POLITICAL COOPERATION**

**CSTO promotes collective security initiatives**

*February 16, 2011*

Kyrgyz President Rosa Otunbayeva welcomed a delegation of the CSTO Secretariat headed by CSTO Secretary General Nikolai Bordyuzha. She acknowledged the urgent need to strengthen Kyrgyzstan's state border. Otunbayeva said that Kyrgyzstan regards the CSTO as a key regional organisation ensuring the security of its member states. One of the country's vital tasks is to protect and strengthen its borders. Decisions made by the CSTO on providing

military and technical aid and equipping border troops are also important, she noted.

Following a meeting with senior officials in the Kyrgyz Defence Ministry the parties evaluated the results of Kyrgyzstan's military and technical cooperation with CSTO countries during the tragic events in the summer of 2010, discussed the prospects of further cooperation within the CSTO, and exchanged opinions on the current social and political situation in Kyrgyzstan. Bordyuzha said the purpose of his visit was to study Kyrgyzstan's newly established system of governance and discuss a number of procedural issues with members of Kyrgyzstan's government and the Prime Minister.

The CSTO delegation has suggested setting up a committee of chiefs of general staff and chiefs of armed service staff of the CSTO member states' armed forces. A special Central Asian military grouping may be created to strengthen collective security. The multilateral grouping will comprise the Collective Rapid Deployment Forces (CRDF) and CRRF, as well as national military formations and troop units.

According to the CSTO Secretary General, the time is right to consider a coalition air defence force, as part of a Joint Air Defence System, headquartered in one of the region's states.

*www.dkb.gov.ru*

### **Joint Air Defence System**

*April 14, 2011*

Kyiv hosted a meeting of the CIS Air Defence Coordination Committee of the CIS Defence Ministers' Council to harmonise draft interstate agreements on establishing regional air defence systems in the Caucasus and Central Asian regions. Russia's Defence Ministry did not specify a date for the possible signing of the agreements.

*Expert Online*

### **Ukraine**

#### **Russian Defence Ministry plans to buy ANTONOV AN-70**

*April 19, 2011*

On April 17-19, 2011 Russian Defence Minister Anatoly Serdyukov met with his counterpart Mikhail Yezhel in Ukraine. The sides discussed military and technical cooperation between Russia and Ukraine and visited several military enterprises and military facilities in Crimea. The Defence Ministers met with Ukrainian President Viktor Yanukovich to discuss Russian-Ukrainian military relations.

Serdyukov visited the NITKA ground-based naval pilot training centre, which Russia uses for training pilots of deck-based aircraft. The Ministers discussed the possibility of training cadets on Russian and Ukrainian naval vessels, and opportunities for the military academy faculty staff in both countries to exchange expertise.

The two Defence Ministers toured the Black Sea Shipyard and the Shipbuilding Plant named after 61 Communards. In addition, the Russian Minister visited the ANTONOV State Aircraft Manufacturing Concern in Kyiv, where he discussed the Russian-Ukrainian project to build AN-70 medium military freighter and modernise AN-124 heavy military transport aircraft. According to Serdyukov, Russia's Defence Ministry is interested in procuring AN-70 aircraft and is currently working on a joint venture to produce the planes in Russia. Russia will be ready to buy AN-70 aircrafts from 2015-2016, he said.

*RIA Novosti*

### **Black Sea Fleet remains controversial**

*May 13, 2011*

The April 2010 "Kharkov agreements" on extending the lease of a naval base to Russia's Black Sea Fleet until 2042 have not resolved all outstanding issues. Russia and Ukraine have therefore agreed to establish a commission on Black Sea Fleet operations. The commission, made up of representatives from the Defence and Foreign Ministries of both states, will deal with contentious issues, such as the movement of Russian military units beyond the range of permanent deployment in Sevastopol.

In January 2011 the parties agreed that the two fleets could use lighthouses in Crimea (previously, navigation facilities have been the subject of heated debate). In addition, experts are considering options for Russia's greater participation in the social and economic development of local communities close to where Black Sea Fleet military personnel are stationed.

Russia and Ukraine also agreed to draw up an inventory of land and real estate rented by the Black Sea Fleet. According to the 1997 Big Treaty, Russia leases 3,312 ha of land in Sevastopol and around 15,000 ha in Crimea. The Black Sea Fleet may now be in a position to relinquish five land plots covering a total 749 ha in the centre of Sevastopol because they are no longer strategically significant. If the Sevastopol authorities find investors for their development, Moscow will release this land. However, the plots may be placed at Russia's disposal at short notice once again. The estimated cost of investment projects, which could be located on former naval land, amounts to \$1.7 billion. Ukrainian investors do not have such sums, and foreign investors appear reluctant to invest in Crimean real estate. Russia therefore remains the only qualified potential investor in such large-scale commercial projects.

*Expert Online*

## Ukraine to charge more rent for hosting the Black Sea Fleet

November 18, 2011

Ukraine's Cabinet of Ministers has recommended that the authorities in Sevastopol should set the rental charges on land used by Russia's Black Sea Fleet at a rate of 3% of their regulatory and monetary value in 2013 and at 4% in 2014. The Cabinet also believes that Ukraine's State Land Resources Agency, its Foreign and Defence Ministries and the State Property Fund should harmonise agreements on inventory and valuation of land used by the Russian Black Sea Fleet in Ukraine by 2013.

Inventory of the Russian Black Sea Fleet's non-military facilities in Crimea began, as agreed, on October 6, 2011. The Cabinet intends to compensate local authorities for any shortfall in their budget revenues caused by the deployment of the Black Sea Fleet on Ukrainian territory. Ukraine's Finance Ministry has suggested that the draft law on state budget should include additional subsidies.

In April 2011, the Ukrainian Foreign Minister Konstantin Gryshchenko said that the market value of the facilities leased to the Fleet will be calculated after the inventory of real estate is concluded.

### Note:

*From May 28, 2017 Russia will pay Ukraine \$100 million annually in return for stationing the Black Sea Fleet in Crimea. Russia's reduced rent will be calculated as 30% of the price of gas supplied to Ukraine.*

Expert Online

## Central Asia

### Russia to extend lease of Tajikistan military base

September 2, 2011

The Russian President Dmitry Medvedev and the Tajik President Emomali Rahmon have given their Defence Ministries the task of preparing an agreement, for signature in early 2012, extending Russia's lease of a military base in Tajikistan by 49 years. Following bilateral negotiations in Dushanbe, Medvedev noted that this agreement must be put together carefully, and must balance the interests of both Tajikistan and Russia.

### Note:

*The Russian base in Tajikistan was set up in 2005 on the premises of the former 201<sup>st</sup> Motorised Rifle Division, a remnant of the Soviet period. The initial agreement signed in April 1999 and implemented in 2004 allowed the base to function until 2014. Russian military units are located in Dushanbe, Qurghonteppa and Kulab.*

Expert Online, RBK daily

## **Central Asian states create joint disaster response centre**

*September 12, 2011*

The Minister of Emergency Situations of the Republic of Kazakhstan Vladimir Bozhko, and the Minister of Emergency Situations of the Kyrgyz Republic Bolotbek Borbiyev have signed the Agreement on Establishing the Intergovernmental Central Asian Centre for Disaster Response and Risk Reduction. Tajikistan's State Committee for Emergency Situations and Civil Defence will sign the document later.

The Centre will be headquartered in Almaty and its remit is to improve regional cooperation and coordination in responding to disasters and reducing risk, thereby enhancing solidarity and improving the safety of people living in the Central Asian region.

The Centre will regularly assess regional risk and response to transborder emergencies. Information and communication systems will be established to ensure effective risk assessment. The real-time gathering, processing and analysing of information will help monitor and prevent emergencies, and will be vital in launching early warning systems. A decision has been taken to create a data and geoinformation system to assess natural and man-made hazards to the population, infrastructure and geographic areas. All systems and databases will be integrated into international monitoring systems and networks for natural and man-made disasters. The Centre will also hold international exercises, rescue missions and humanitarian operations in Central Asia and other countries.

It is anticipated that the Central Asian Centre for Disaster Response and Risk Reduction will strengthen member states' national platforms or other multi-disciplinary mechanisms for reducing disaster risk in the region.

*Expert Kazakhstan*

## **Russia, Kazakhstan to set up joint air-defence system**

*September 22, 2011*

According to Colonel General Valery Gerasimov, deputy chief of the General Staff of Russia's Armed Forces, Russia and Kazakhstan are planning to set up a joint air defence system in the near term.

Russia already operates bilateral regional air defence systems with Belarus and Armenia and is planning a similar arrangement with Kazakhstan. Gerasimov noted that a bilateral air defence system with Kazakhstan could be created "in the nearest future". At present Kazakhstan's air defence system is part of the Joint CIS Air Defence System.

*Expert Online*

### US military base to remain in Kyrgyzstan till 2014

*November 23, 2011*

The Manas US military base will remain in Kyrgyzstan till the year 2014, as agreed by Kyrgyzstan and the United States, Kyrgyzstan's outgoing president Roza Otunbayeva said. She stressed that the base is vital for the international coalition force in Afghanistan. The fate of the Manas base after 2014 will depend largely on the situation in that country. Otunbayeva said that President-elect Almazbek Atambayev had suggested that the base should be closed when the lease expires and the capital's main airport, Manas, should be transformed into a civilian transit centre. Otunbayeva backed this proposal, noting that Kyrgyzstan needs a big transport hub to handle goods shipped from west to east and vice versa.

#### Note:

*The Manas base was established in late 2001 after the United States went to war against the Taliban and al-Qaeda in Afghanistan. The military base, which was subsequently renamed the Transit Centre, now accommodates about 1,200 American soldiers.*

*Expert Online*



## CIS countries: primary macroeconomic indicators

Elvira Kurmanalieva  
Konstantin Fedorov

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In 2011, the world's debt problems, which became particularly critical in the Eurozone countries, had a negative effect on most of the economies of the CIS region and their short-term outlooks. The year was characterised by increased turbulence on financial markets, caused by a string of negative economic and financial outcomes. Deterioration of the economic situation in developed countries affected developing economies, which experienced a drop in external

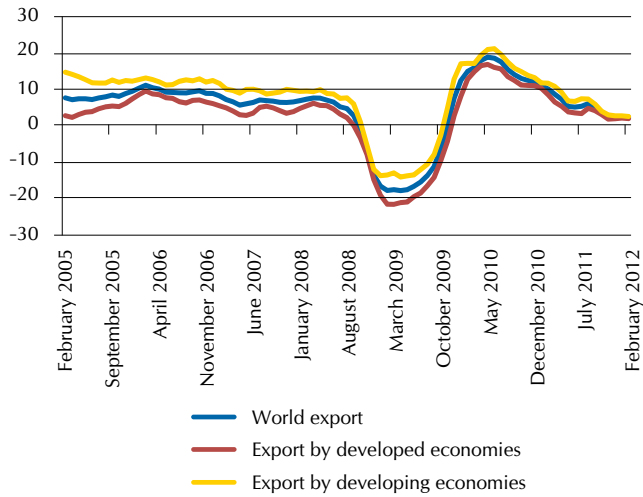
demand for their products and a slowdown in foreign investment, resulting in the decline of the annual economic growth rate of China – the key driver of economic processes in the Asian region in 2011 – to below its 2010 level. As a result, global trade growth declined from 12.7% in late 2010 to 2.4% in December 2011, and the world GDP growth rate fell from 4.9% in 2010 to 3.3% in 2011.

The CIS economies managed to resist the global trend, increasing their combined growth rate from 4.4% in 2010 to 4.6% in 2011 with the highest growth rate

**Figure 14.1.**  
**World trade**

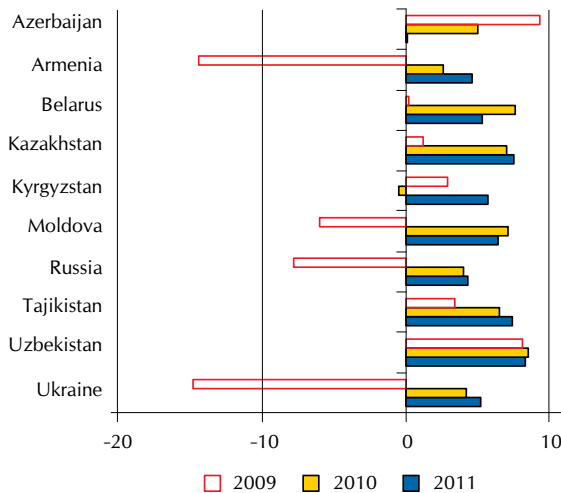
(%, 3 month moving average compared with that of the previous year)

Source: World Trade Monitor, February 2012



**Figure 14.2.**  
**GDP growth in CIS countries (%)**

Source: national agencies, the CIS Statistics Committee



recorded in Turkmenistan (14.7%) and the lowest in Azerbaijan (0.1%). A record high agricultural crop in CIS countries in 2011, in addition to the low base effect caused by the droughts in 2010, led to a weighted average increase of 20% in the region's agricultural output following a 9% drop in 2010. Signs of recovery were also observed in the construction and financial sectors, especially in the second half of 2011. However, industrial output growth slowed down in the region's largest economies, primarily due to a rise in prices for industrial products and a fall in demand.

Throughout 2011, the dynamics of current account balances were above all determined by significant fluctuations in prices for raw material resources and foodstuffs. In particular, the average annual price of Brent crude futures rose by 38.1% from \$80.3 per barrel in 2010 to \$110.9 in 2011. The price of gold, which was viewed by investors as a "safe haven" amid the unpredictability and volatility on the markets, also reached record highs. The trade surpluses of net exporters of raw materials grew significantly, bringing in additional revenues and helping to increase their gold and foreign exchange reserves. On the other hand, net importers of petroleum products and foodstuffs registered an increase in their trade deficits, which were to a considerable extent compensated for by a rise in cash remittances from labour migrants. This risk-sharing mechanism allowed most of the CIS countries to largely alleviate the growing risks and withstand the slowdown in the world economy.

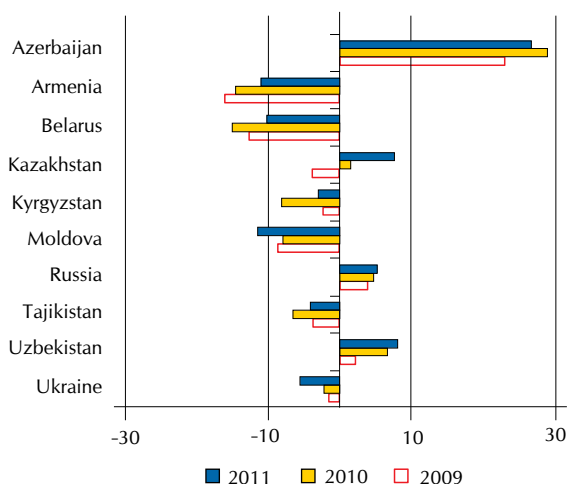
The region's balance of payments account in 2011 was characterised by an outflow of surplus capital in the form of direct and portfolio investment from net oil-product-exporting countries, and by an inflow of direct investment and credit to the labour-exporting countries that are also net importers of crude oil and foodstuffs. According to the balance of payments data, the region's overall net capital outflow (the current account balance excluding changes in central bank reserves) exceeded \$80 billion in 2011.

Therefore, the region's 2011 balance of payments dynamics led to a net increase of \$33 billion (about 1.5% of the region's GDP) in the reserve assets of the central banks. The largest increase in foreign exchange reserves occurred in Azerbaijan, where reserves grew by 19.3% of GDP, while in Ukraine they decreased by 1.7% of GDP. In 2011, the real effective exchange rate of the national currency appreciated by 6.9% in Kyrgyzstan, 5.9% in Moldova and 4.8% in Russia, and fell by 12.7% in Belarus and 1.4% in Armenia.

An increase in foreign currency proceeds and the economic revival in the region had a favourable effect on CIS countries' public revenues, facilitating increases in social spending and public sector wages. Increased public revenues from exports and a moderate fiscal policy led to the emergence of significant budget surpluses in Kazakhstan and Russia. In the countries with chronic budget deficits, external public debt was high. Nevertheless, the economic situation made it possible to decrease external public debt in most of the CIS countries.

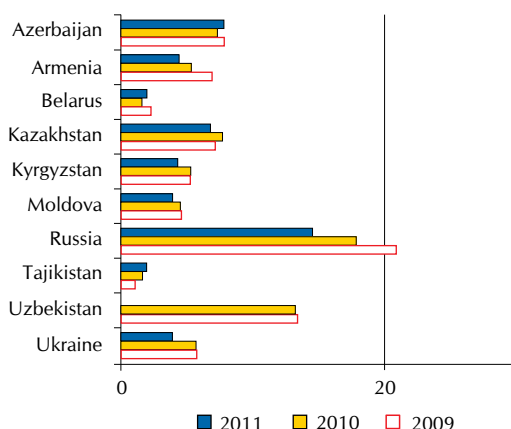
**Figure 14.3.**  
Current account  
of the balance of  
payments:  
(% of GDP)

Source: national  
agencies



**Figure 14.4.**  
Gold and forex  
reserves: (in months  
of imports of goods  
and services)

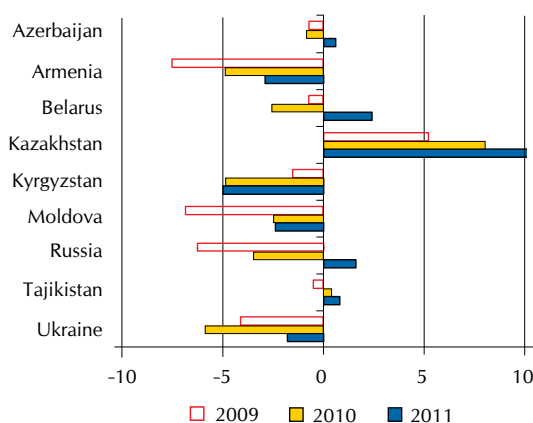
Source: national  
agencies



Public debt decreased by 6% of GDP on average in Kyrgyzstan, Tajikistan and Ukraine.

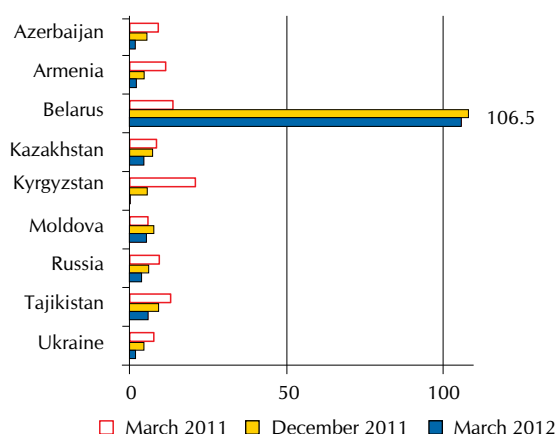
The rise in prices, which was mainly caused by a surge in world prices for raw materials and foodstuffs, slowed down significantly in late 2011 and early 2012, partially due to tightening of monetary policy in all CIS countries. In March 2012, the lowest inflation rates were observed in Kyrgyzstan (0.2%), Azerbaijan (1.8%) and Armenia (1.9%). The Belarusian economy, which suffered from a severe balance of payments crisis in 2011, showed signs of stabilisation due to a sharp depreciation of the national currency and anti-crisis measures taken by the government, allowing to stop the Belarusian ruble's devaluation, and decelerate price growth, which reached 106.5% year on year in March.

Commercial banks revived their lending activities in 2011. The volume of loans issued in roubles increased by more than 25% in Russia, substantially exceeding the 2010 growth rate of 5.6%. In Kazakhstan, lending in tenge rose by 21.5%. The 2011 credit expansion was characterised by a relatively slow rise in foreign currency lending, at least in major CIS economies. In the latter half of 2011, companies increased their investment activity; however, it remained restrained given the private sector's uncertainty over the risks associated with negative external factors. The share of problem loans in the loan portfolio of the CIS countries' banking sectors gradually decreased but remained significant.



**Figure 14.5.**  
 State budget:  
 consolidated budget  
 balance (% of GDP)

Source: the CIS  
 Statistics Committee,  
 national agencies



**Figure 14.6.**  
 Monetary sphere:  
 CPI growth  
 (% year on year)

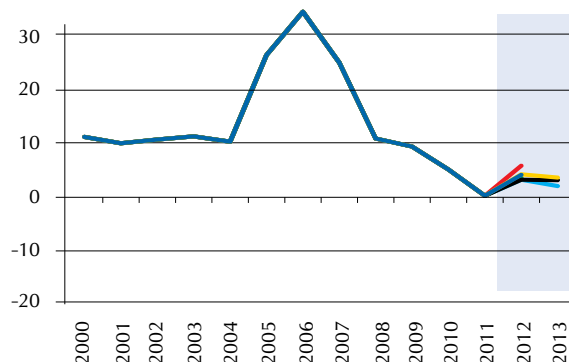
Source: national  
 agencies

In the second half of 2011 and early 2012, many experts made a downward revision of their forecasts for world economic growth. National agencies in the CIS countries also lowered their forecasts. Consensus GDP growth forecasts

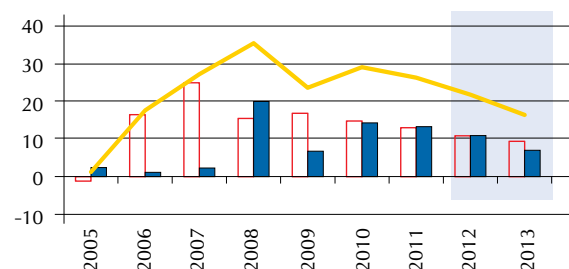
were considerably lowered in Belarus (a decrease of 3.5% from 4.6% to 1.1%); Ukraine (a decrease of 0.9%); Russia (down 0.5%), and Moldova (0.4%). At the same time, GDP growth forecasts for Central Asian countries were revised upward. As a result, while in the middle of 2011 the region's economic growth forecast for 2012 was 4.6%, at present the weighted average consensus forecast is 4.1% for 2012 and 4.3% for 2013.

Given the continuing recession in the world economy, some external risk does remain, due to the high dependence of the region's large economies on external demand for the raw materials that constitute the bulk of their exports. The debt crisis in European countries may seriously affect the stability of the global financial system, and also poses a threat to the growth of the CIS economies. According to the EDB's forecast, if oil prices remain at the current level of around \$115 a barrel or decline slightly, the region's weighted average economic growth rate would amount to 4.9% in 2012 and increase to 5.2% in 2013. A more

**a) Economic growth:** GDP growth and forecasts by national and international institutions (%)



**b) Savings and investments (% of GDP):** balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)



□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

**Figure 14.7.**  
**Azerbaijan:**  
**Economic situation**

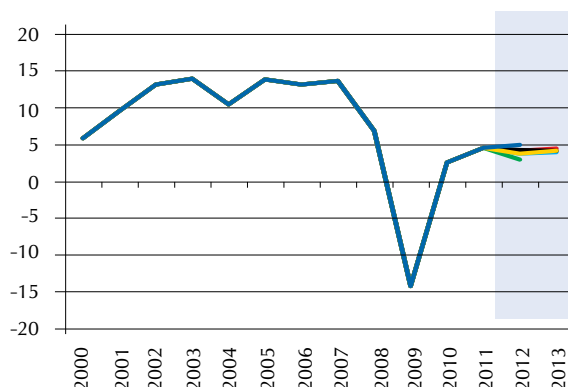
Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

pessimistic scenario assumes further deterioration in the economic situation in the Eurozone and a further slowdown of the global economy, affecting oil prices that would presumably fall to \$90 per barrel on average in 2012 and 2013. This would slow the CIS economies' growth to 3.2% in 2012 and to 3.9% in 2013.

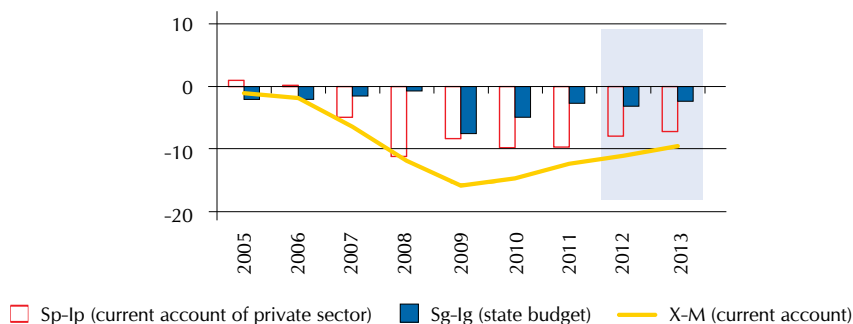
	2008	2009	2010	2011
GDP growth (% yoy)	10.8	9.3	5.0	0.1
GDP per capita (\$)	5,213	4,798	5,713	6,125
CPI growth (% yoy)	20.8	1.8	7.8	5.5
State budget balance (% of GDP)	20.3	6.8	13.6	9.8
Current account balance (% of GDP)	35.5	23.0	29.0	22.6

**Azerbaijan:**  
**Primary indicators**  
 (statistics and  
 estimates by national  
 agencies and the  
 IMF)

**a) Economic growth: GDP growth and forecasts**  
 by national and international institutions (%)



**b) Savings and investments (% of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)**



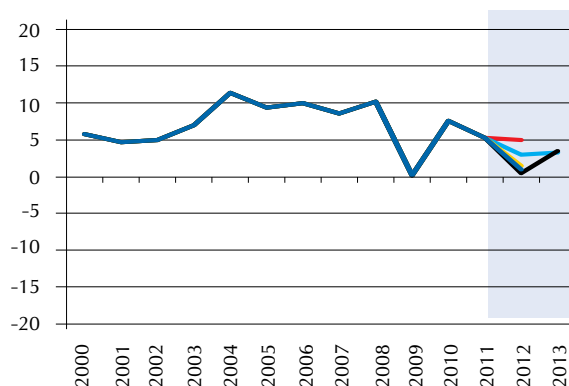
**Figure 14.8.**  
**Armenia:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

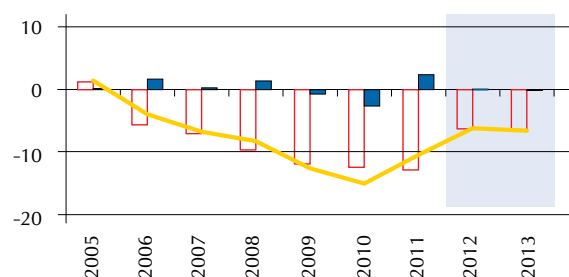
**Armenia:**  
**Primary indicators**  
(statistics and  
estimates by national  
agencies and the  
IMF)

	2008	2009	2010	2011
GDP growth (% yoy)	6.9	-14.2	2.6	4.6
GDP per capita (\$)	3,606	2,647	2,840	3,012
CPI growth (% yoy)	5.2	6.5	9.4	4.7
State budget balance (% of GDP)	-0.7	-7.5	-4.9	-1.5
Current account balance (% of GDP)	-11.8	-16.0	-14.5	-11.7

**a) Economic growth: GDP growth and forecasts**  
by national and international institutions (%)



**b) Savings and investments (% of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)**



□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

**Figure 14.9.**  
**Belarus:**  
**Economic situation**

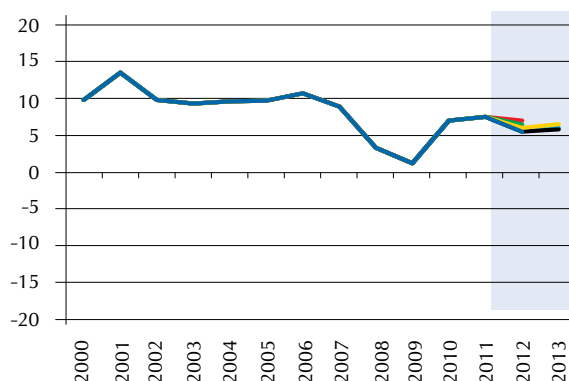
Source: national  
agencies, estimates  
by the ADB, the  
World Bank, the  
EBRD, the IMF and  
the CIS Statistics  
Committee

**Belarus:**  
**Primary indicators**  
(statistics and  
estimates by national  
agencies and the  
IMF):

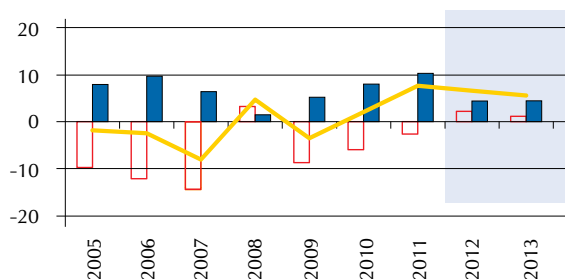
	2008	2009	2010	2011	Q1 2012
GDP growth (% yoy)	10.2	0.2	7.6	5.3	-
GDP per capita (\$)	6,372	5,171	5,811	5,854	-
CPI growth (% yoy)	13.3	10.1	9.9	108.7	-
State budget balance (% of GDP)	1.4	-0.7	-2.6	2.4	-
Current account balance (% of GDP)	-8.2	-12.6	-15.0	-10.2	-



**a) Economic growth: GDP growth and forecasts**  
 by national and international institutions (%)



**b) Savings and investments (% of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)**



□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

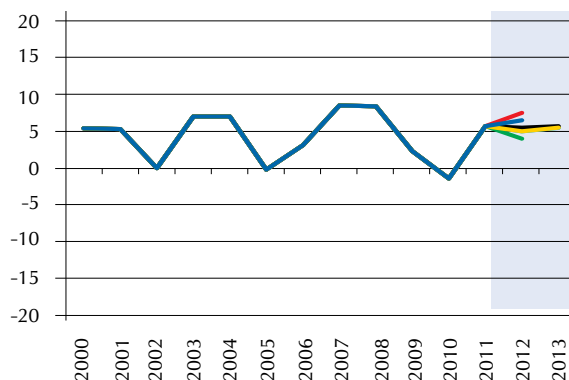
**Figure 14.10.**  
**Kazakhstan:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

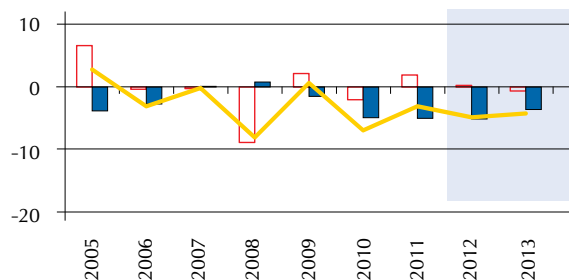
	2008	2009	2010	2011
GDP growth (% yoy)	3.3	1.2	7.0	7.5
GDP per capita (\$)	8,713	7,127	8,980	11,163
CPI growth (% yoy)	9.5	6.2	7.8	7.4
State budget balance (% of GDP)	1.3	5.2	8.0	10.3
Current account balance (% of GDP)	4.8	-3.7	2.0	5.9

**Kazakhstan:**  
**Primary indicators**  
 (statistics and estimates by national agencies and the IMF):

**a) Economic growth: GDP growth and forecasts**  
by national and international institutions (%)



**b) Savings and investments (% of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)**



□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

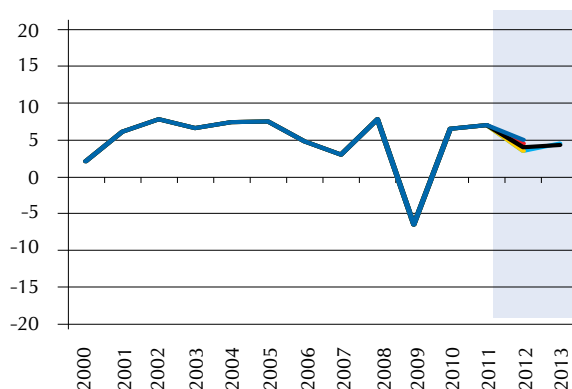
**Figure 14.11.**  
**Kyrgyzstan:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

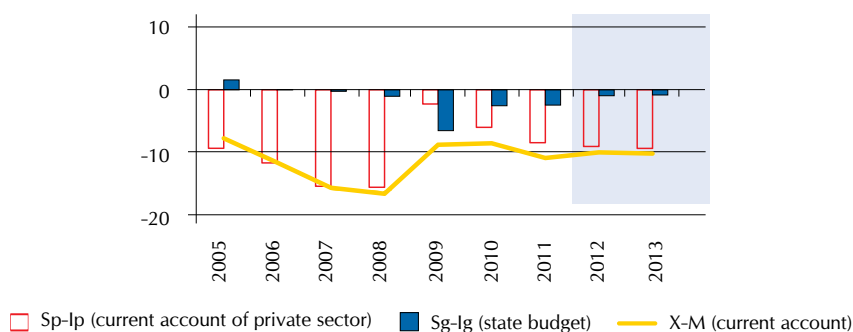
**Kyrgyzstan:**  
**Primary indicators**  
(statistics and estimates by national agencies and the IMF):

	2008	2009	2010	2011
GDP growth (% yoy)	8.4	2.9	-0.5	5.7
GDP per capita (\$)	949	856	832	1,093
CPI growth (% yoy)	20.0	0.0	19.2	5.7
State budget balance (% of GDP)	0.8	-1.5	-4.9	-5.0
Current account balance (% of GDP)	-13.7	-2.3	-8.4	-7.7

**a) Economic growth: GDP growth and forecasts**  
 by national and international institutions (%)



**b) Savings and investments (% of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)**



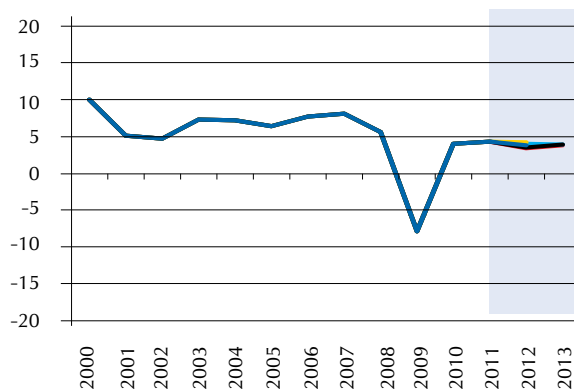
**Figure 14.12.**  
**Moldova:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

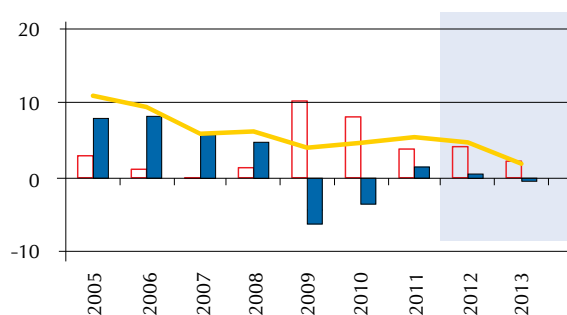
	2008	2009	2010	2011
GDP growth (% yoy)	7.8	-6.5	6.5	7.0
GDP per capita (\$)	1,667	1,509	1,624	1,945
CPI growth (% yoy)	7.2	0.5	8.0	7.8
State budget balance (% of GDP)	-1.0	-6.3	-2.5	-1.9
Current account balance (% of GDP)	-17.0	-9.9	-9.8	-9.9

**Moldova:**  
**Primary indicators**  
 (statistics and estimates by national agencies and the IMF):

**a) Economic growth: GDP growth and forecasts**  
by national and international institutions (%)



**b) Savings and investments (% of GDP):** balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)



**Figure 14.13.**  
**Russia:**  
**Economic situation**

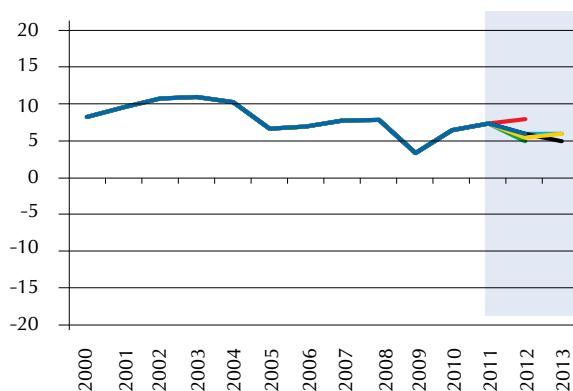
Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

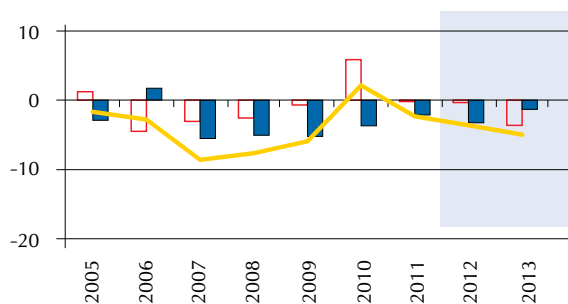
**Russia:**  
**Primary indicators**  
(statistics and estimates by national agencies and the IMF):

	2008	2009	2010	2011	Q1 2012
GDP growth (% yoy)	5.2	-7.8	4.3	4.3	4.9
GDP per capita (\$)	11,919	8,852	10,811	12,986	-
CPI growth (% yoy)	13.3	8.8	8.8	6.1	3.7
State budget balance (% of GDP)	4.9	-6.3	-3.5	1.6	-
Current account balance (% of GDP)	6.2	3.9	4.8	5.5	-

**a) Economic growth: GDP growth and forecasts**  
 by national and international institutions (%)



**b) Savings and investments (% of GDP):** balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)



□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

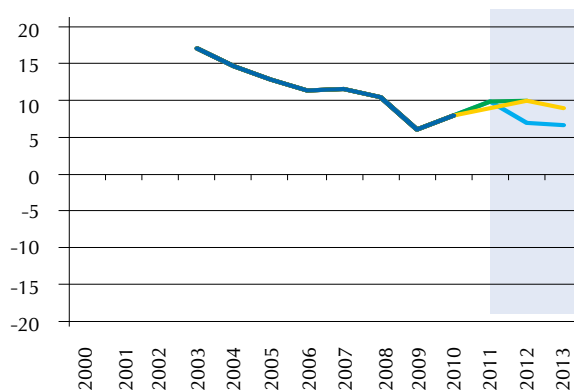
**Figure 14.14.**  
**Tajikistan:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

	2008	2009	2010	2011
GDP growth (% yoy)	7.9	3.4	6.5	7.4
GDP per capita (\$)	755	716	797	858
CPI growth (% yoy)	11.8	5.0	9.8	9.3
State budget balance (% of GDP)	1.6	-0.5	0.4	0.8
Current account balance (% of GDP)	0.9	-3.7	-6.5	-3.6

**Tajikistan:**  
**Primary indicators**  
 (statistics and estimates by national agencies and the IMF):

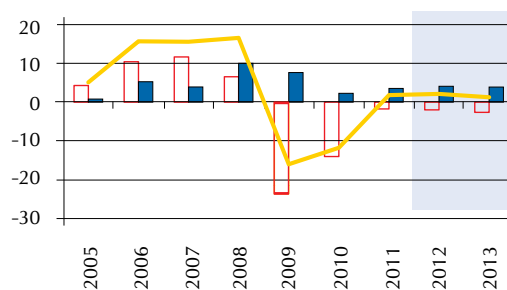
**a) Economic growth: GDP growth and forecasts**  
by national and international institutions (%)



**b) Savings and investments (% of GDP):** balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)

**Figure 14.15.**  
**Turkmenistan:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

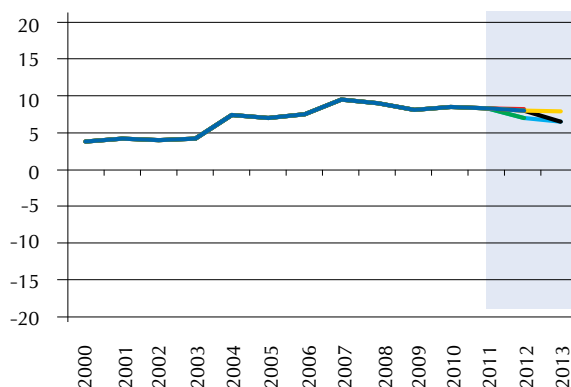


□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

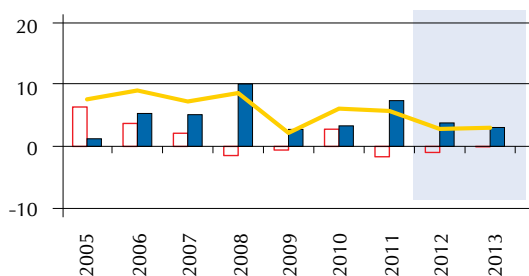
**Turkmenistan:**  
**Primary indicators**  
(statistics and estimates by national agencies and the IMF):

	2008	2009	2010	2011
GDP growth (% yoy)	10.5	6.1	8.0	7.4
GDP per capita (\$)	-	-	-	-
CPI growth (% yoy)	-	-	-	-
State budget balance (% of GDP)	10.0	7.6	2.3	0.5
Current account balance (% of GDP)	16.5	-16.0	-11.7	-2.9

a) **Economic growth: GDP growth and forecasts**  
 by national and international institutions (%)



b) **Savings and investments (% of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)**



□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

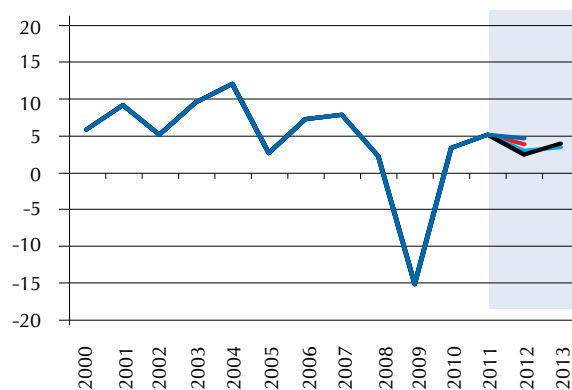
**Figure 14.16.**  
**Uzbekistan:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee

	2008	2009	2010	2011
GDP growth (% yoy)	9.0	8.1	8.5	8.3
GDP per capita (\$)	-	-	-	-
CPI growth (% yoy)	12.7	14.1	7.3	7.6
State budget balance (% of GDP)	10.7	3.1	2.7	3.3
Current account balance (% of GDP)	8.7	2.2	6.7	8.0

**Uzbekistan:**  
**Primary indicators**  
 (statistics and estimates by national agencies and the IMF):

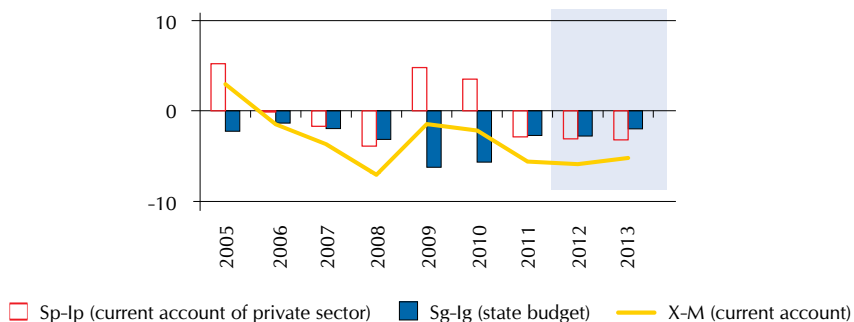
**a) Economic growth: GDP growth and forecasts by national and international institutions (%)**



**b) Savings and investments (% of GDP): balance of private investment and savings (Sp-Ip), state budget (Sg-Ig), current account (X-M)**

**Figure 14.17.**  
**Ukraine:**  
**Economic situation**

Source: national agencies, estimates by the ADB, the World Bank, the EBRD, the IMF and the CIS Statistics Committee



□ Sp-Ip (current account of private sector) ■ Sg-Ig (state budget) — X-M (current account)

**Ukraine:**  
**Primary indicators**  
(statistics and estimates by national agencies and the IMF):

	2008	2009	2010	2011
GDP growth (% yoy)	2.3	-15.1	3.4	5.2
GDP per capita (\$)	3,914	2,565	3,003	3,624
CPI growth (% yoy)	22.3	12.3	9.1	4.6
State budget balance (% of GDP)	-3.2	-6.3	-5.7	-2.8
Current account balance (% of GDP)	-7.0	-1.5	-2.2	-5.9



# Multilateral and Regional Development Banks in Northern and Central Eurasia: Overview of Activities in 2011

Ella Baybikova

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This paper aims to analyse the activities of the international and regional development banks in the Central Asian states of Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, as well as Armenia, Belarus, Russia and Ukraine. 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), the European Investment Bank (EIB) and the Islamic Development Bank (IsDB). The legal ground for any multilateral development bank (MDB) activities in the country is, primarily, the country's membership in the bank, which is also provided with immunity and the special legal status of international organisation.

While analysing the MDBs' activities, this paper proceeded from the information listed on the websites of the aforementioned MDBs. The first part of the overview dwells upon the thematic initiatives and analytical activities of the multilateral development banks, while the second section of the current paper focuses on cooperation and coordination for the purpose of boosting the efficiency of the provided assistance. The third part is devoted to the MDBs' investment activities in the countries of the region.

It should be noted, however, that the annual reports for 2011 had not been published when this article was written, so it is based on the data published by the MDBs 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 2011

The year 2011 may be characterised as a year of the post-crisis revival of the region's economies, leading to an upsurge in the region's demand in investments. On May 11, 2011, London hosted a meeting of the MDBs' leadership to discuss issues of the post-crisis recovery of economies and their subsequent growth and development. The participants of the meeting noted the increase in disparity and a high level of unemployment, and underlined the need to develop, in coordination with the G-20, a joint action plan aimed at reducing the volatility of food prices and increasing food and water security.

Moreover, 2011 was notable for the development of bilateral cooperation between the MDBs. The Asian Development Bank and the OPEC Fund for International Development (OFID) signed a memorandum to expand cooperation between the two organisations. A framework agreement on cooperation has also been signed by the International Financial Corporation (IFC) and the Eurasian Development Bank.

In addition to providing direct financing, the MDBs focused their attention on joint initiatives to boost aid efficiency both in general and in certain fields. Some initiatives resulted in the establishment of a number of special funds to underline the targeted nature of the assistance. Moreover, issues of providing development assistance to some of the region's countries were also on the agenda of the MDBs.

Thus, the EBRD's Board of Directors has approved a new country strategy for the Kyrgyz Republic, which is designed to ensure continued EBRD support for the recovery of the country's economy and sustainable growth after a period of social and political unrest in the recent past. The EBRD's key priorities under the new country strategy will be supporting local private enterprises (with a particular focus on the agribusiness sector) stabilising and developing the country's financial sector, and strengthening vital infrastructure.

The World Bank Board of Directors discussed a new Interim Strategy Note (ISN) for the Kyrgyz Republic. The strategy was adopted a year earlier and focuses on supporting the stabilisation and recovery of Kyrgyzstan. The ISN has been guided by the insights of the World Bank's World Development Report 2011 "Conflict, Security and Development".

The survey of Ukraine's investment climate, conducted by the IFC with the support of the Canadian International Development Agency (CIDA), the Agency for International Business and Cooperation of the Dutch Ministry of Economic Affairs (EVD), the Swedish International Development Cooperation Agency (SIDA) and the Swiss Confederation through its State Secretariat for Economic Affairs (SECO) among managers and owners of over 2,000 enterprises and sole proprietors in Ukraine, assessed the efficiency of the reform process and provided short-to-medium term policy recommendations.

Energy efficiency and environmental issues, as well as the public private partnership, have traditionally been on the MDBs' agenda and will be discussed hereafter in this section of the paper.

### **Energy Efficiency**

Energy efficiency is of key importance to the sustainable development of the Eurasian region, given the relatively high energy intensity of its economies.

The EBRD and the Grantham Research Institute have published the joint report on switching to a low-carbon economic model. The Low Carbon Transition report puts forward structural reforms and measures to encourage private investments, and stands for the implementation of energy efficiency norms and standards. The report underlines, that the transition to low-carbon economy may be costly particularly for the energy importers in the region.

In order to implement the corresponding programmes and coordinate their efforts, the MDBs establish strategic partnerships. Thus, the Eastern Europe Energy Efficiency and Environment Partnership Fund (E5P), a €90 million multi-donor fund managed by the EBRD, has been put into effect, and reported about financing energy efficiency projects in Moldova, Kazakhstan, Russia and Ukraine, as well as Latvia and Estonia during the period under review.

Moreover, the EBRD implements a specialised energy efficiency initiative in Ukraine – the \$160 million Ukraine Energy Efficiency programme (UKEEP), which is nearing completion. UKEEP has to date financed almost 40 individual energy efficiency and renewable energy projects worth nearly \$110 million. Collectively, UKEEP funded projects achieved energy savings of up to 2.2 million MWh per year. Total CO<sub>2</sub> savings as a result of UKEEP implementation stand at 520,000 tonnes per year – the equivalent of the emissions from 220,000 passenger cars. The programme is supported by several important technical assistance components financed by the governments of Sweden and Austria.

In addition, the EBRD supports the development of Ukrainian machine building companies through financing the modernisation of their production complexes and improving the systems of energy management and consumption. The project is supported by technical cooperation funds provided by the UK government.

The World Bank is also active in financing energy efficiency projects. The World Bank's Board of Directors has approved a \$200 million loan to Ukraine to finance investments in energy-saving programmes in industrial companies, municipalities and municipal-owned companies, as well as energy service companies in 2011.

IFC, a member of the World Bank Group, held the Energy Efficiency Expo 2011 in Armenia that aims to develop the market of energy efficiency projects, raise public awareness of the energy efficiency innovation technologies, and develop cooperative ties between manufacturers.

Moreover, IFC announced it has teamed up with the Russian Energy Agency and signed an agreement with the Ukrainian State Agency for Energy Efficiency to launch an awareness campaign and create a knowledge-sharing platform for entrepreneurs to promote best practices in resource management and use of renewable energy in the agribusiness sector, where IFC supports the entire value chain from farm production to collection, processing and distribution.

The EDB announced the launch of a special energy efficiency and resource conservation programme, which will be implemented via financial institutions – the EDB clients. The EDB and the UN Development Programme (UNDP) have signed a memorandum of understanding in the spheres of energy efficiency, energy conservation, environmental protection, food safety, water resources management and rural development. The EDB and the UNDP will focus on renewable energy projects in rural areas of Central Asia with an emphasis on the small hydro. In addition, the organisations will conduct a joint study of the challenges of joint management of the hydropower potential of the Central Asian cross-border rivers, and support the interstate Russian-Kazakh cooperation addressing conservation and sustainable management of the Ural River Basin transboundary ecosystems.

Given that Uzbekistan has one of the highest electricity consumption per GDP in the world, aggravated by heavy transmission and distribution losses, the ADB is financing the Advanced Electricity Metering Project for the installation of modern electricity meters. The project will also fund skills training for the staff of Uzbekenergo state-owned power utility company.

### **Environmental Issues and Mitigation of Climate Change**

Environmental issues top the agenda of the MDBs. The international donor community contributed an additional €550 million to the efforts to transform the Chernobyl Nuclear Power Plant into an environmentally safe site and create the conditions for a long-term solution for reactor 4, which was destroyed in the 1986 accident at Chernobyl. The additional financial means will replenish the Chernobyl Shelter Fund and the Nuclear Safety Account – the two EBRD-managed funds through which the Shelter Implementation Plan for reactor 4 and the Spent Fuel Storage Facility for reactors 1-3 are funded. The total cost for the Shelter Implementation Plan will be €1.54 billion. Moreover, the EBRD launched the new website [www.chernobyltwentyfive.org](http://www.chernobyltwentyfive.org) which provides comprehensive information about the international efforts to transform Chernobyl into an environmentally safe site.

MDBs have established a new partnership to combat global warming and support cities in adapting to and mitigating climate change. The five MDBs (ADB, EBRD, Inter-American Development Bank, WB and African Development Bank)

said they would develop a common approach for cities to assess climate risk, standardise greenhouse gas emissions inventories, and encourage a consistent suite of climate finance options.

The world's coastal marshes became a point of interest for the World Bank. In its new report, written jointly with the International Union for the Conservation of Nature (IUCN) and wetland specialists ESA PWA, the WB warned that drainage and degradation of coastal wetlands causes them to emit significant amounts of carbon dioxide directly to the atmosphere, and leads to reduced carbon sequestration.

The World Bank launched two new financial initiatives – the Carbon Initiative for Development (Ci-Dev) and the third tranche of the BioCarbon Fund (BioCF T3) – to help the least-developed countries access financing for low-carbon investments and purchase certified emission reductions (commonly called 'carbon credits') from a diverse range of projects. The Ci-Dev, aiming to raise \$120 million, is a partnership of donor and recipient countries where public and private sector entities are pledging their support to capacity building and carbon market development in the poorest countries of the world. The BioCF T3 will focus on reforestation and agriculture projects that go hand in hand with co-benefits such as decreased soil erosion and increased land fertility.

EBRD joined the World Bank-led Global Gas Flaring Reduction partnership (GGFR) to help governments in Azerbaijan, Kazakhstan, Russia and Turkmenistan introduce energy efficiency measures to improve business competitiveness and environmental standards in oil and gas operations.

IFC has become the first multilateral development bank to sign the United Nations Principles for Responsible Investment (UNPRI), extending its efforts to mobilise capital for investments that are environmentally and socially responsible and adhere to high standards of corporate governance. As part of their collaboration, IFC and the UNPRI will initially focus on joint organisation of events in emerging markets to help raise awareness of the business case for responsible investment.

Moreover, IFC launched a new financial mechanism to promote homegrown "green" innovation in developing countries while encouraging the transfer of clean technologies from developed to developing countries. The \$60 million Cleantech Innovation Facility will target small, highly innovative start-up companies that offer products or services that mitigate carbon emissions.

In 2011, IFC closed the IFC Post-2012 Carbon Facility after it was fully subscribed for €150 million. The fund will extend carbon markets to help increase access to finance for projects that promote environmentally friendly economic growth and reduce greenhouse-gas emissions.

In addition, IFC held its fifth annual Community of Learning, a knowledge-sharing forum aimed at strengthening the environmental and social risk-management of financial institutions and supporting sustainable ways of doing business for companies in emerging markets. Starting January 1, 2012, IFC will put into effect its updated Performance Standards that were revised in critical areas such as climate change, business and human rights, consultations with project-affected communities (including indigenous peoples), and supply-chain management.

ADB released a report on sustainable development, which describes the wide range of measures taken to improve environmental sustainability in the Asia-Pacific region. ADB supports programmes for low-carbon development and adaptation to climate change, as well as resilience of agricultural systems and natural resource management.

The EDB published a new analytical review, *The Safety of Hydroworks in Central Asia: Problems and Approaches*, which was prepared jointly with the group of experts of the Executive Committee of the International Fund for saving the Aral Sea (EC IFAS). Hydroworks are necessary for the comprehensive use of water resources, including drinking, industrial and agricultural water supply; irrigation, hydropower, fishery, navigation, recreation, and ecosystems maintenance. The paper provides a brief overview of the best practice of state regulation of hydroworks' safety and status monitoring in Central Asia, Russia and other countries, and discusses the prospects of regional cooperation in this field.

The Black Sea Trade and Development Bank (BSTDB) signed a new agreement with the Nordic Investment Bank (NIB) opening a loan facility aimed at reducing greenhouse gas emissions in the BSTDB member countries. The new loan programme has a 10-year maturity and totals €30 million. At least 70% of the loan programme is to be allocated for the purpose of reducing emissions of greenhouse gases in countries around the Black Sea. Sub-projects are expected to be implemented in the sectors of renewable energy, energy efficiency and energy saving as well as public transportation.

### **Public Private Partnership (PPP)**

The WB published a new report, *Public Private Partnerships in Europe and Central Asia: Designing Crisis-Resilient Strategies and Bankable Projects*, which finds that despite the challenges of the past three years, public private partnerships (PPP) globally, and in the Europe and Central Asia region in particular, can still bring value to the economy. The report also calls on governments in the Eastern Europe and Central Asia region to look not just at private investors, but to also seek a larger role for international partners, which may play a more crucial role in helping the design and financing of projects, strengthening institutional capacity and mitigating risks. MDBs' lending and guarantee instruments can

help mitigate key government and project risks, making them more attractive to private investors and improving financial sustainability.

Moreover, the MDBs held a series of seminars and forums on issues of the public private partnership. BSTDB sponsored the Southeastern Europe and the Mediterranean PPP Forum organised jointly by the Greek Ministry of Regional Development and Competitiveness and the World Bank Institute. ADB held two thematic seminars, *The Role of the Private Sector in Promoting Regional Integration: Trade and Cross-Border Infrastructure and Bridging the Gap: Catalyzing Private Capital for Investment in Infrastructure*. The participants of both seminars noted that the PPP issue is relevant to all organisations. Public and private sectors should work together; with governments and development banks unable to finance the gamut of investments needed in the region, private sector participation is key. Development finance institutions around the world should encourage greater use of risk-sharing models like public-private partnerships to ensure critical infrastructure gets built in developing countries. The institutions should do that by helping create the right regulatory and market environment and offering risk mitigation instruments to spur private capital.

### **Integration Studies**

ADB and ADBI recently published a new book, *Institutions for Regional Integration: Toward an Asian Economic Community*. The authors of the joint study believe that more effective and efficient institutions are needed to complement Asia's market-driven regional integration and to manage the challenges of Asia's expanding role in the global economy. The institutional architecture needs to be strengthened to consolidate Asia's hard-won economic gains, extend the benefits of cooperation beyond East Asia, and ensure the compatibility of regional and global integration. The book also offers three specific recommendations: strengthening and rationalising existing institutions for regional integration such as the Association of Southeast Asian Nations (ASEAN), the South Asian Association for Regional Cooperation, and the Pacific Islands Forum; further developing existing institutions to exploit functional opportunities; and establishing new pan-Asian institutions and empowering existing ones.

The EDB Centre for Integration Studies, established in 2011, presented a new study, *Scientific and Technological Cooperation between Russia and Ukraine: Forecasting Opportunities and Mechanisms for Their Implementation*, conducted by the Institute of National Economy Forecasting of the Russian Academy of Sciences and the Institute of Economics and Forecasting of the National Academy of Sciences of Ukraine on the initiative of the EDB. The study stressed that reviving cooperation in science and technology will give both economies a real chance of becoming prominent players on international markets of science-intensive products.

ADB published a new issue of its flagship annual economic publication that provides a comprehensive analysis of macroeconomic and development issues of the developing Asia, Asian Development Outlook 2011. The report focused on its new special theme of South-South economic linkages.

### **Business Activity Support**

In addition to standard programmes for supporting microfinancing and small and medium enterprises (SME) through targeted funding of commercial banks and non-bank financial institutions, the MDBs are looking for new ways to support businesses in developing countries.

The EBRD launched a new venture capital investment programme for early and growth stage companies operating in technology sectors. The programme is a long-term commitment to technology financing in the EBRD region – including the future region of the southern and eastern Mediterranean – with the Bank setting up a €100 million capital pool, dedicated team, and an advisory committee including outside experts and approval process. The region, in which the Bank operates, despite being home to an educated population and many technological innovations, is under-served by venture capital investment.

IFC invested \$100 million in a capital release fund, marking the first time IFC has joined private investors to help banks free up existing capital and use it to boost loans to small and medium enterprises in emerging markets. The fund, established and managed by New York- and London-based business Christofferson, Robb & Company, aims to help big international banks reduce the capital that new international rules (Basel III) will force them to set aside against loans to small companies in emerging markets by offering risk protection for specific SME loan portfolios. This can lower banks' capital costs of lending to SME, and therefore free up capacity for them to do new SME credit business.

### **Trade and Trade Financing**

While changing market conditions are threatening the availability of trade finance in the regions of the world where it is needed most, the MDBs have taken several steps to alleviate the lack of financial resources and spur economic growth in emerging markets and developing countries worldwide.

In 2011, the African Development Bank (AfDB), the International Trade Centre (ITC), the UN Conference on Trade and Development (UNCTAD) and the World Bank, in cooperation with the UN Statistics Division (UNSD), launched the Transparency in Trade Initiative (TNT), a global programme that will give more access to influential trade data. The TNT is a joint project that will help eliminate the transparency gap resulting from the lack of access to data on country-specific trade policies. Free access to data will make it easier for exporters and policy-makers to meet relevant standards and requirements and better monitor and analyse trade-related projects.



## IMPROVING THE ORGANISATIONAL EFFECTIVENESS OF DEVELOPMENT BANKS IN 2011

The leaders of 31 development finance institutions joined the Corporate Governance Development Framework, a common set of guidelines created to support sustainable economic development in emerging markets. Through the Framework, the signatories hope to answer the G-20's call for development finance institutions to strengthen their coordination and ensure accomplishment of certain key institutional reforms, such as an increased commitment to transparency, accountability, and good corporate governance, as well as raise awareness, both at the private and public sector levels. Each institution that adopts this Framework undertake to provide training to ensure capacity building and share knowledge on corporate governance, collaborate with other signatories to share experiences and resources on training and implementation, and report annually on the implementation of the Framework. The MDBs are expected to implement the Framework at their own pace and at a level that suits their institutions.

Nearly 2,000 senior officials from over 100 countries attended the three-day Fourth High-Level Forum on Aid Effectiveness in Busan, South Korea. In preparation for the forum, the multilateral development banks, including the WB, EBRD, the Inter-American Development Bank, ADB and IsDB, prepared a Joint Note that highlighted their performance on aid effectiveness, transparency and accountability matters and what needs to be done in this regard in the future. Similarly, the members of the Coordination Group jointly prepared a Statement of Resolve to highlight the improvement of foreign aid effectiveness and underline the Group's readiness to agree on a new monitoring framework that will routinely assess aid delivery and performance at the country level.

Moreover, MDBs deepened their bilateral interaction in several spheres of their activities.

The World Bank and the EDB signed the Implementation Plan for the Framework Cooperation Agreement between the WB and the EDB for 2011-2013 that foresees collaboration between the World Bank and EDB in the following key areas: strengthening of the analysis of economic situation in the EurAsEC member countries; joint preparation and implementation of projects in infrastructure, energy and government institutions development; promoting regional collaboration in trade, investment and labour migration to the benefit of the client countries and so on. Within the framework of the Implementation Plan, the WB and the EDB held their first joint conference on economic developments and prospects of EurAsEC countries in December 2011 in Almaty. The conference focused on the impact of current global developments on the EurAsEC countries, integration trends in the CIS and the EurAsEC, and issues of employment and migration in the region.

The EBRD and ADB signed a memorandum of understanding to strengthen and deepen cooperation in the organisations' common countries of operation: Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan.

The IsDB and ADB signed a framework co-financing agreement for a total of \$6 billion to jointly support projects in such areas as agriculture, food security, rural development, human development, education and health, private sector development and credit insurance.

IFC and the EIB signed an agreement to strengthen their collaboration when financing private sector development projects in emerging markets. Greater cooperation will directly benefit public-private partnerships and project finance operations. Areas of cooperation and coordination include the execution of mandate agreements, the appraisal and due diligence process, monitoring visits, and the handling of client requests.

On November 25, 2011 Baku hosted a forum that brought together ministers and senior representatives of development agencies to discuss support for the new 10-year strategy for the Central Asia Regional Economic Cooperation (CAREC) Programme. Established in 2001, CAREC brings together Afghanistan, Azerbaijan, the People's Republic of China, Kazakhstan, Kyrgyzstan, Mongolia, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan. It promotes the implementation of regional projects in energy, transport and trade. Six multilateral institutions support the work of CAREC: ADB, EBRD, IMF, IsDB, United Nations Development Programme, and World Bank. Since 2001, CAREC-related investments have totalled \$17 billion in over 100 projects in energy, trade and transportation.

### **Securities offerings**

The debt securities markets offered favourable market conditions for the MDBs in 2011, allowing some banks to raise additional funding.

The ADB placed a \$2.75 billion five-year global benchmark bond issue. The bonds, with a coupon rate of 2.50% per annum payable semi-annually and a maturity date of March 15, 2016, were priced at 99.603% to yield 24.65 basis points over the 2% US Treasury notes due January 2016. By investor types, 52% of the bonds went to central bank and government institutions, 28% to banks, 16% to fund managers and 4% to others.

EDB accessed the securities market several times throughout the year. In February 2011, the bank placed its fourth issue of 7-year bonds with a six-month coupon for a total of 5 billion roubles. In accordance with the terms of this issuance, the bonds may be redeemed in three years. The 1-6 coupon rate was set at 7.70% per annum. In May 2011, the Bank issued \$25 million (maturity of 184 days)

and €32 million (364-days maturity) under the euro commercial paper (ECP) programme established earlier. On November 18, the EDB placed another issue of its ECP worth \$40 million with a maturity of one year.

The EBRD launched its first ever syndicated transaction in the Sterling market in an amount of GBP 200 million. The issue carries an annual coupon of 1.875% and has a final maturity date of December 10, 2013. The bond was priced at a spread of 55 basis points over the UK Gilt, with an issue price of 99.826%.

IFC launched its first renminbi-denominated bond, using the proceeds to finance a clean technology project in China. It marked the first such issue by a supranational. The five-year bond has a 1.80% per annum interest rate and raised CNY 150 million (around \$23 million) to support technology that helps to promote energy efficiency and to lower greenhouse gas emissions.

In April 2011, IFC announced the pricing of a five-year \$2 billion benchmark issue, part of its regular programme of raising funds for private sector development lending. This was the first sub-Libor five-year issue by a supranational since the fall of 2008. The bonds, which mature on April 11, 2016 and carry a semi-annual coupon of 2.25%, were priced to yield 18.4 basis points over the benchmark five-year U.S. Treasury bond.

Moreover, IFC issued a series of Uridashi Green Bonds, denominated in a foreign currency. Funds raised from IFC Uridashi Green Bonds are set aside in a separate account for investing exclusively in renewable energy, energy efficiency, and other climate-friendly projects in developing countries. Projects that may be funded by the Green Bonds include rehabilitation of power plants and transmission facilities to reduce greenhouse-gas emissions, solar and wind installations, and funding for new technologies that result in significant reductions in emissions. In total, the four tranches raised \$135 million. The first tranche of AUD 42.3 million with a fixed annual coupon rate of 4.860% was placed in February 2011. The second tranche of ZAR 175.7 million with a fixed annual coupon rate of 6.100% was placed in May 2011, as well as the third tranche of €15.8 million with a fixed annual coupon rate of 1.430% and the fourth tranche of AUD 41.3 million with a fixed annual coupon rate of 4.750%.

EIB placed several bond issues for a total of €70 billion during the period under review. First of all, the Bank placed several €3 billion benchmark Euro Area Reference Note (EARN) issues in the 10-year sector. Moreover, the EIB priced a new €3 billion benchmark Euro Area Reference Note (EARN) in the 7-year sector. The issue carries an annual coupon of 2.50% and has a final maturity of October 15, 2018. The bond was priced at a spread of mid-swaps plus 18 bps, which was in line with initial price guidance. The transaction represents EIB's first EARN in the 7-year sector since 2009 and the fifth new EARN benchmark of 2011.

### **Asian Development Bank**

The ADB is an effective, transparent, client-focused organisation, and should continue with current efforts to further improve its effectiveness, says a new donor assessment report. The report, commissioned by the Multilateral Organisation Performance Assessment Network (MOPAN) consisting of 16 donor countries, gives ADB satisfactory to high marks in most key performance indicators, including in areas such as making transparent decisions in allocating resources, focusing on achieving results, reporting results information clearly, and harmonising procedures with other development partners. Over 100 respondents, comprising mostly donors and governments, took part in the survey.

In 2011, the ADB set up a new multi-donor trust fund to support participation of developing countries at the next global forum on aid effectiveness. The Fourth High Level Forum on Aid Effectiveness Trust Fund, to be administered by ADB, will take contributions from bilateral, multilateral and individual sources, including corporations and foundations. The fund will contribute towards ADB efforts to support developing countries to take ownership of the aid effectiveness agenda. It reflects ADB's continuing strong commitment to the Paris Declaration on Aid Effectiveness. Contributions to the fund will be on an untied grant basis, with money pooled together in one account. The fund will be held and invested at the discretion of ADB and will terminate once the bulk of money has been disbursed.

The development of the CAREC Transport Corridors was a top priority in the ADB investment activities in the region in 2011 as in previous years.

### **The World Bank Group**

With the aim of raising its operating efficiency, the WB approved a new mechanism that will allow the world's poorest countries to expedite access to funding following a crisis. The Immediate Response Mechanism complements longer-term emergency response tools available to members of the International Development Association (IDA), the Bank's fund for the poorest, offering countries financial support within weeks rather than months of an emergency.

The WB launched global public consultations (March-May 2011) on a proposed new lending instrument – Programme-for-Results (P4R) – that would support government programmes and link disbursements to the achievement of results. The guiding principles and key elements of this proposed new instrument are discussed in the Concept Note – A New Instrument to Advance Development Effectiveness: Programme-for-Results Lending. The P4R instrument responds to demands from the Bank's client governments, who are implementing their own development programmes and increasingly want partners for finance and expertise to improve the effectiveness and efficiency of those programmes in achieving results.

Moreover, the WB launched the Justice Peer-Assisted Learning (JUST-PAL) Network, a cooperative peer-based learning and knowledge-sharing resource on justice issues for all countries in Europe and Central Asia. An internet-based JUST-PAL Knowledge Portal was also launched on April 12, 2011 ([www.justpal.org](http://www.justpal.org)). The JUST-PAL Network comprises four main directions for exchange of experience: budgeting, physical infrastructure, information systems, and court management and administration.

### **European Bank for Reconstruction and Development**

In 2011, the three leading international rating agencies – Standard & Poor's, Moody's and Fitch – reaffirmed their AAA ratings for the debt of the EBRD, underscoring the Bank's stability at a time of turbulence in financial markets. The agencies also described the outlook for the Bank's debt as stable. They referred specifically to the EBRD's strong capital position, which has been bolstered by a capital increase to which all of the EBRD's major shareholders have now subscribed.

During the period under review the EBRD launched the Private Sector for Food Security Initiative to help address the global challenge of food security via greater involvement of the private sector in efforts to match the rising demand for food with adequate supplies from the agricultural sector. The programme will aim specifically to:

1. Address bottlenecks along the whole food value chain by providing an effective menu of commercially viable responses;
2. Match more effectively the supply and demand from food exporters and food importers;
3. Provide greater opportunities for private-public sector dialogue to address the needs of the private sector;
4. Enhance coordination among the relevant international financial institutions and multilateral development banks to address both food as well as water security issues.

The private sector involvement is key to unlocking the agricultural potential in countries such as Russia, Ukraine and Kazakhstan – three producer nations that could supply half the world's grain needs.

Moreover, the EBRD launched a new venture capital investment programme for early and growth stage companies operating in technology sectors. The programme is a long-term commitment to technology financing in the EBRD region. Even Russia and Turkey, home to promising technology industries, do not have access to sufficient venture capital financing. To implement the programme the Bank set up a €100 million capital pool, dedicated team, and an advisory committee including outside experts and approval process. The Bank

estimates that it will invest in 10-20 companies in the region over the next four years and will seek to invest alongside leading local and international venture capital investors. The programme will aim to back companies which already have early revenues and/or strategic partnerships and can demonstrate strong growth potential.

The Eastern Europe Energy Efficiency and Environment Partnership (E5P) Fund was put into operation in 2011. E5P is a €90 million multi-donor fund managed by the EBRD designed to promote energy efficiency investments in Ukraine and other eastern European countries. E5P is expected to provide grant funding to Ukraine as well as Armenia, Azerbaijan, Belarus, Georgia and Moldova, where high energy intensity is widespread and there remains wide scope for efficiency improvement across all economic sectors. In addition to promoting energy efficiency in district heating projects, funding will also support other investments aimed at making substantial energy savings. Environmental projects, such as waste water or renewable energy, will also be within the scope of the grant funding.

### **Islamic Development Bank**

In 2011, the three leading international rating agencies reaffirmed the IsDB ratings. Accordingly, on August 24, 2011 Moody's Investors Service reaffirmed the IsDB's "Aaa" long-term foreign currency issuer rating with a stable outlook. Moody's stated that IsDB's rating reflects the presence of strong shareholder support, a high level of liquidity and a low level of debt.

At a ceremony in Washington the IsDB signed the Memorandum of Understanding between the International Organisation of Supreme Audit Institutions (INTOSAI) and the donor community. The IsDB is the sixteenth development partner organisation to join the Memorandum, which represents a global effort to encourage donor countries to engage in financial management of public funds. The INTOSAI-Donor Memorandum aims at scaling up and enhancing the support provided to supreme audit institutions in developing countries. Since it was signed in 2009, the Memorandum has played an important role in securing donor funding for several regional supreme audit institutions capacity development initiatives. The signatories to the INTOSAI-Donor Memorandum are INTOSAI, the African Development Bank, Austria, Belgium, Canada, the European Commission, the Inter-American Development Bank, the IMF, Ireland, the IsDB, Netherlands, Norway, Sweden, Switzerland, the United Kingdom, the USA, and the WB.

### **Eurasian Development Bank**

The leading international rating agencies reaffirmed the EDB ratings in 2011. Moody's Investors Service assigned the EDB a long-term foreign currency rating of A3 and a short-term rating of P-2. The outlook on the bank's ratings is stable. Fitch Ratings changed the EDB's outlook to Positive from Negative. It also

affirmed EDB's long-term Issuer Default Rating (IDR) at "BBB" and upgraded its short-term IDR to "F2" from "F3". In addition, Standard & Poor's published its new ratings for the EDB, affirming the Bank's current ratings at BBB (long-term) and A-3 (short-term) with stable outlook, which reflects that on the Russian Federation. According to S&P report, the current ratings confirm the Bank's stable capital position and strong shareholder support.

In June 2011, the EDB launched the Centre for Integration Studies aimed at conducting the research work and drafting reports and recommendations to the governments of the EDB member states on the issues relating to regional economic integration. The Centre's research priorities include trade, economic and corporate integration; foreign exchange and financial integration; theoretical comprehension of the Eurasian integration.

Moreover, EDB expanded its membership as the EDB Council unanimously approved accession of a new member to the Bank, Kyrgyzstan, on June 27, 2011.

On October 13, 2011 the EDB held its 6th International Conference, Customs Union and EurAsEC's Single Economic Space: Prospects for Further Integration. The EDB's annual conferences on issues of Eurasian integration traditionally gather heads of state administration bodies of the EDB member states, leading researchers, experts and specialists from the EurAsEC and the CIS member states and foreign countries, as well as representatives of mass media. The participants of the conference focused on the best practices of economic integration in the EurAsEC and CIS member states, a search for new ways of multilateral cooperation, evaluation of the prospects for the expansion of the Customs Union and formation of the Eurasian Single Economic Space, the EurAsEC Anti-Crisis Fund activities and coordination of joint anti-crisis strategies in the region.

In addition, the EDB took part in its first ever transaction arranging one-year syndicated Islamic finance for Russia's AK BARS Bank. The syndicated facility totalled \$60 million, including the EDB's share of \$20 million. The EDB acted as a mandated lead arranger for the project. The transaction was arranged with the participation of Citibank N.A., London, and the Islamic Corporation for the Development of the Private Sector as joint lead arrangers and bookrunners. The specifics of Islamic finance are that it must be consistent with Sharia laws, in accordance with which money cannot and should not be made out of money. In particular, this principle prohibits interest-bearing loans. For this reason, the transaction was structured in accordance with the Murabaha Agreement, a product of Islamic finance that provides for the purchase and sale of Sharia-consistent goods.

On December 21, 2011 the Bank's Council revised the EDB Strategy for 2011-2013 to include new sections on country priorities and interaction with international organisations.



### 3. MDB'S PROJECTS IN 2011 IN THE REGION BY COUNTRY

#### Armenia

##### Asian Development Bank

The Asian Development Bank provided financial assistance to help Armenia upgrade its urban transport services to improve living conditions and bolster economic opportunities in the country's major and secondary cities. In May 2011, the ADB Board of Directors approved a multitranche financing facility for a Sustainable Urban Transport Project in Yerevan. The first tranche of \$48.64 million is earmarked for the construction of a 5.3 km ring road in Armenia's capital, Yerevan, which will divert traffic from the center and support increased economic development in outer areas.

Moreover, within the framework of its Trade Finance Programme, ADB signed trade finance agreements with six banks in Armenia, a move that is expected to further bolster the country's trade sector and help ensure sustainable economic growth in the Central Asian country. The agreements were signed with Ameriabank CJSC, Anelik Bank CJSC, Ardshininvestbank CJSC, Armeconombank OJSC, Converse Bank CJSC, and Unibank Armenia CJSC.

Under its Armenian SME Finance Programme ADB has approved loans of up to \$65 million to four Armenian banks – ACBA Credit Agricole Bank (\$20 million), Ardshininvestbank (\$15 million), Ameriabank (\$20 million), and Inecobank (\$65 million).

In addition, ADB provided financing for the reconstruction and widening of the Ashtarak-Talin road section within the framework of the North-South Road Corridor Investment Programme in the total amount of \$170 million.

##### The World Bank Group

IBRD and IDA, members of the World Bank Group, have invested a total of \$110 million in six projects in Armenia during 2011.

The World Bank's Board of Executive Directors approved an \$18 million loan for the Additional Financing of the Irrigation Rehabilitation Emergency Project (IREP) for Armenia. The Project's total financing amounts to \$21.6 million. The IBRD loan carries a maturity of 25 years including a grace period of 10 years.

The WB approved a package designed to help Armenia protect the poor and support greater human capital development, and also strengthen competitiveness and private sector development. The Second Development Policy Operation (DPO) for Armenia includes an IDA credit equivalent of \$21 million and an IBRD loan of \$4 million. The IDA credit carries a maturity of 20 years including a grace period of 10 years and the IBRD loan has a maturity of 25 years including a 10-year grace period.



A \$39 million loan for the Electricity Supply Reliability (ESR) Project was allocated for improving the capacity of the power transmission network backbone infrastructure by replacing a section of around 230 km of transmission line from the Hrazdan Thermal Power Plant (TPP) to Vorotan Cascade of hydropower plants. Total financing of the Project amounts to \$52 million, of which the Government of Armenia will finance \$13 million. The IBRD loan carries a maturity of 25 years including a grace period of 10 years.

In mid May 2011, IFC, a member of the World Bank Group, and the Ministry of Energy and Natural Resources of Armenia, signed a cooperation agreement to increase the efficiency of Armenia's energy system by introducing new renewable energy sources within the framework of the IFC Armenia Sustainable Energy Finance Project, designed to establish a sustainable market for energy efficiency and renewable energy investments and contribute to the energy self-sufficiency of Armenia.

Moreover, WB provided \$5 million for construction of small hydropower plants in Armenia. EBRD and Cascade Universal Credit Organisation co-financed the project in the amount of \$7 million and \$3 million respectively.

Within the framework of the Community Agricultural Resource Management and Competitiveness (CARMAC) Project the WB approved a \$16 million IDA credit with a maturity of 20 years including a grace period of 10 years. This project will introduce innovative community-based pasture/fodder-based livestock production practices in selected mountainous communities where livestock production is the main source of cash income and livelihood. The project will also provide grants to farmers for enhancing farm sales of livestock products.

Within the SME financing programme, IFC provided loans of \$5 million and \$20 million to Armeconombank and ACBA-Credit Agricole Bank respectively.

### **European Bank for Reconstruction and Development**

Apart from the aforementioned project for construction of small hydropower plants, financed in collaboration with the World Bank, the EBRD supported the expansion of financing services in Armenia with a 750 million Armenian Dram loan (\$2 million equivalent) to Araratbank for on-lending to small and medium enterprises (SME). The Bank's first local currency loan in Armenia launched the EBRD's new Local Currency Lending Programme in Early Transition Countries.

EBRD extended a €6.5 million loan to the state-owned Armenian Water and Sewerage Company to improve water supply and wastewater services in 17 municipalities across Armenia and build two wastewater treatment plants.

Moreover, EBRD supported the development of the telecoms, information and media sector in Armenia with a \$2.2 million quasi-equity investment

in Interactive TV LLC, a digital cable TV service provider, for expanding its broadband internet services.

The Bank has arranged a loan to Araratbank for on-lending to small businesses in Armenia and secured the participation of three international commercial banks. The EBRD will contribute \$3 million to the total \$12 million financing package, with the balance syndicated to Russia's Promsvyazbank, VDK Spaarbank nv of Belgium and Lebanon's Byblos Bank S.A.L.

### **Eurasian Development Bank**

The EDB has not participated in the projects in Armenia in 2011.

### **European Investment Bank**

The EIB approved financing for two projects in Armenia in 2011 for a total amount of \$23 million equivalent. Resources of the Direct Investments Fund (€1.25 million) were allocated for renewable energy project, while another €15 million (equivalent to \$21.45 million) was channeled to SMEs via the financial institutions.

## **Belarus**

### **The World Bank Group**

On February 14, 2011 the IBRD, a member of the World Bank Group, approved the allocation of a \$5 million nonrefundable subsidy to the Belarusian Economy Ministry for restructuring and privatisation of state-owned enterprises. In the second half of 2011, the Belarusian authorities together with the WB and international advisors selected ten companies ready to go private, including the Baranovichi Reinforced Concrete Plant (99% owned by the state), Brest Electromechanical Plant (83,8%), Belsantekhmontazh-2 (77,4%), Construction and Mounting Trust No.8 (85,3%), Avtomagistral (83,5%), Belgazstroj (50,6%), Medplast (99,9%), Barkhim (99,6%), Konfa (25%), and Minsk Margarine Factory (93,8%).

IFC, a member of the World Bank Group, continued to actively support the development of the country's real sector by providing a corporate package of long-term loans for a combined amount of up to \$21 million comprising a loan of up to \$15 million for IFC's own account and a syndicated loan for financing the Rublyovsky-II project in the field of wholesale and retail sales of food products.

Moreover, IFC agreed to finance the establishment of a new soft drinks plant located near Minsk, Belarus. The proposed IFC investment is in the amount of \$10 million, consisting of an estimated \$8.2 million loan for the plant's construction and a \$1.8 million IFC participation in the capital increase of DB Juice (Cyprus) Limited, which is the holding company.

In addition, in May 2011 IFC launched a new training programme for Belarusian food producers within the framework of its Belarus Food Safety Project in order to increase awareness of international food safety standards and their benefits for food processing companies.

### **Eurasian Development Bank**

On June 4, 2011, the Council of the EurAsEC Anti-Crisis Fund (ACF, managed by the EDB) approved a financial credit to Belarus in the amount of \$3 billion. The funds will be disbursed in tranches during 2011–2013 as Belarus implements its governmental programme aimed at stabilising the balance of payment and increasing the competitiveness of the Belarusian economy. The loan has a maturity of 10 years including a 3-year grace period. The financial terms of the loan conform to standard conditions that are approved by the ACF for the participating countries with average incomes.

EDB provided financing for six projects in Belarus in 2011 for a total of over \$307 million, including the project for construction of Polotsk Hydropower Plant on the Western Dvina River (\$99.8 million).

In April 2011, EDB signed a loan agreement with the Osipovich Wagon Works, under which the plant received a \$63.5 million facility for eight years to arrange cutting-edge hi-tech production of freight cars and tank containers in Osipovich.

EDB extended \$100 million to Belaruskali in a syndicated loan with Russia's Sberbank. The loan was provided against guarantees from the Belarusian government for the company's general corporate purposes. The \$1 billion syndicated loan agreement was signed by the EDB and Sberbank with Belaruskali on November 18, 2011 in Minsk. The project is in line with the EDB strategic goals to foster sustainable growth, modernisation and economic competitiveness of the EDB member states.

Within the framework of its Trade Financing Programme, the EDB signed agreements with two Belarusian banks, Belgazprombank and Belinvestbank, for \$20 million each. In addition, the bank approved \$4 million financing to Belarusian Paritetbank as part of a syndicated loan together with a group of banks.

### **European Bank for Reconstruction and Development**

EBRD long-term loans totalling €26 million will help Vakaru Medienos Grupe, a Lithuanian-owned wood-processing company, build a large plant in Belarus for what is planned as the first stage of a furniture-making cluster whose output is ear-marked for large retailers in the region. An eight-year EBRD senior loan of €19.5 million and an eight-year subordinated one of €6.5 million will support the construction of an integrated plant for production of particleboards, plywood and furniture in the Mogilev free economic zone.

Moreover, in order to encourage the development of private enterprise in a country where the public sector accounts for 70% GDP, EBRD issued a loan of \$50 million to Belpromstroybank for lending to micro, small and medium enterprises.

In addition, EBRD extended a loan of €50 million to Kronospan FLLC, Belarus to finance construction of a melamine faced particleboard production plant at Smorgon in Grodno region.

## **Kazakhstan**

### **Asian Development Bank**

ADB extended a loan of \$95 million for construction of a 65-km road section in Zhambyl Oblast between the cities of Taraz and Baipas within the framework of the CAREC Transport Corridor-1 Investment Programme. Moreover, ADB supported the Astana Light Rail Transit Project and provided technical assistance in the amount of \$565,000.

### **The World Bank Group**

The IBRD issued the adaptable programme loan of \$22.81 million for Kazakhstan's Statistics Agency to improve the efficiency and effectiveness of the national statistical system to provide relevant, timely and reliable data in line with internationally accepted methodology and best practices.

IFC provided a long-term local currency loan of \$25 million to refinance the existing short-term obligations, improve the current debt structure and help closer match the structure of assets and liabilities of JSC Kazpost.

Moreover, in late August, IFC signed an agreement with the National Bank of Kazakhstan to expand IFC's capacity to provide local currency loans to companies operating in Kazakhstan and support growth of the country's private sector.

### **Eurasian Development Bank**

During the period under review, the EDB invested in six new projects and increased its financial support for the previously approved project in Kazakhstan. The total EDB commitments in Kazakhstan stood at \$355 million equivalent in 2011.

The EDB signed a \$50 million loan agreement with Ivogla-Holding LLC to fund purchases of fertilizers, chemical defense equipment, fuels and lubricants and other goods and services necessary for sowing and harvesting campaigns.

Moreover, the EDB provided financing for KazExportAstyk Holding's programme to optimise its balance sheet in the amount of \$35.2 million.

The Bank increased the financing of the APK-Invest Corporation's project for purchases and exports of grain harvested in 2010-2012 from \$50 million to \$75 million.

Moreover, the EDB agreed to extend a \$44 million loan to Astanapromstroy-M for construction of a hotel and office complex in Astana.

The EDB allocated \$98 million to fund JSC Altynalmas' investment project for developing gold production in Kazakhstan. This investment project is being implemented in accordance with the State Programme for Boosting Industrial and Innovation Development in Kazakhstan and Kazakhstan's Mining and Metallurgy Development Programme for 2010-2014.

In December 2011 the EDB signed a loan agreement with Bogatyr-Komir LLC to provide investment financing in the amount of up to \$50 million to Kazakhstan's largest coal mining company.

The EDB opened a ten-year loan facility for the Kazatomprom Sulphuric Acid Plant in the amount of \$52.486 million for sulphuric acid plant reconstruction and purchases of modern equipment to ensure uninterrupted supplies of sulphuric acid to Kazatomprom's uranium mining companies.

### **European Bank for Reconstruction and Development**

During the period under review, the EBRD financed six projects in Kazakhstan for a total amount of over \$340 million.

EBRD supported the modernisation of oil drilling services in southern Kazakhstan with a \$10 million loan, and modernisation of district heating networks in Pavlodar, Ekibastuz and Petropavlovsk with a facility totalling of up to €21.7 million co-financed by the Clean Technology Fund (CTF) for an amount of up to \$10 million.

Moreover, EBRD provided a senior secured loan of 3.1 billion Kazakh tenge (equivalent to €15 million) for 10 years with a two-year grace period to finance the reconstruction of Sogrinsk TPP near Ust-Kamenogorsk to increase its electricity production, significantly reduce greenhouse gas emissions and enhance environmental security in the region.

EBRD helped to modernise the transmission of electricity in Kazakhstan with a \$156 million loan that will improve energy efficiency in the system and increase electricity transmission capacities with the rehabilitation of a high-voltage power transmission line in Ossakarovka in Karaganda region.

In addition, the EBRD provided a €80 million loan to the Kazakh subsidiaries of METRO Group, the major German retailer, to finance the expansion of its wholesale facilities in the country.

EBRD extended a new \$20 million trade finance guarantee facility to VTB Kazakhstan, a subsidiary of OJSC Bank VTB of Russia, to support Kazakhstan's exporters and importers and facilitate the financing of foreign trade.

Together with the Kazakh power distribution company KEGOC the EBRD provided a €160,000 grant (\$229,000 equivalent) to improve energy efficiency at the School No.25 in Astana. Working with the Ministry of Environmental Protection of Kazakhstan, the EBRD's Energy Efficiency and Climate Change team developed an investment programme especially designed for the school.

Moreover, EBRD approved an equity investment of up to \$50 million in Petrolinvest S.A. in Kazakhstan to complete second stage oil exploration works in two of its most relevant prospects (OTG and EMBA fields), and adopt best practice corporate governance standards in preparation for an IPO.

In November 2011, the EBRD and the Ministry of Industry and New Technologies of Kazakhstan signed a Memorandum of Understanding, in which the two sides agreed to support the Business Advisory Services (BAS) that the EBRD will provide in Kazakhstan. Over three years the EBRD will aim to provide consultancy services to about 450 small and medium businesses in Kazakhstan and to develop the local market for business advisory services.

### **Islamic Development Bank**

In 2011, the IsDB agreed to provide a 10-year \$10 million loan to a subsidiary of KazAgro National Holding, JSC Fund for Financial Support of Agriculture, to finance Kazakhstan's agriculture micro-lending programme.

### **Kyrgyz Republic**

#### **Asian Development Bank**

The Asian Development Bank (ADB) has approved a \$55 million loan to finance the construction of the 60-km Beit-Torugart section of the highway connecting the Kyrgyz Republic with the People's Republic of China (PRC). The project is part of the Central Asian Regional Economic Cooperation (CAREC) Programme.

Moreover, in September 2011, ADB allocated a grant of \$20 million to Kyrgyzstan for Improving Business Environment Programme – Subproject-2. The funds will be spent on improving credit information exchange between financial institutions with regard to lowering credit risks, boosting leasing development as a means of financing expansion, and promoting the establishment of favourable conditions for public private partnership.

In addition, ADB provided a loan of \$10 million to Kyrgyzstan's two financial institutions, Kyrgyz Investment and Credit Bank, for boosting the development of small and medium-sized enterprises.

## **The World Bank Group**

In June 2011, the WB approved Second Additional Financing to support the ongoing Health and Social Protection Project (HSPP) in the Kyrgyz Republic. The funding in the amount of \$24 million consisted of a \$13.2 million highly concessional IDA credit with a maturity of 40 years and a 10-year grace period, and a \$10.8 million IDA grant.

In August 2011, the WB provided a \$30 million additional financing (IDA credit of \$16.5 million and IDA grant of \$13.5 million) for the Economic Recovery Support Operation (ERSO) for Kyrgyzstan to support Government's reforms for improving governance and strengthening accountability mechanisms, and for post-conflict recovery, transition to medium term growth and poverty reduction.

Moreover, WB approved an additional grant in the amount of \$1 million to support the Disaster Hazard Mitigation Project in Kyrgyzstan to minimise the exposure of humans, livestock, and riverine flora and fauna to radionuclides associated with abandoned uranium mine tailings and waste rock dumps in the Mailuu-Suu area; improve the effectiveness of emergency management and response by national and sub-national authorities and local communities to disaster situations; and reduce the potential loss of life and property in key landslide areas of the country.

IFC approved a \$2.5 million loan to Magic Box, the leading producer of small cardboard packages in the Kyrgyz Republic with exports to Kazakhstan and Tajikistan. The funds will help finance the Company's expansion.

On April 21, 2011 IFC approved a \$6 million senior loan (or local currency equivalent) to FINCA MicroCredit Company, a leading microfinance company in Kyrgyzstan. Proceeds of the loan will be used to finance the expansion of FINCA's lending to micro and small entrepreneurs.

## **Eurasian Development Bank**

Kyrgyz Republic completed the necessary procedures for joining the EDB and became its sixth full-fledged member in 2011. Thus, the EDB has not commenced the financing of investment projects in the country that year.

## **European Bank for Reconstruction and Development**

During the period under review, the EBRD financed six projects in the Kyrgyz Republic for a total amount of around \$56 million.

The EBRD provided a \$10.1 million sovereign loan, accompanied by a \$5.5 million grant from the EBRD's Shareholder Special Fund for development of the public transportation system in Kyrgyzstan, including the acquisition of about 44 high-floor and 32 low-floor (accessible for disabled passengers and passengers with prams) trolleybuses, and partial upgrade of related infrastructure.

The Bank extended a new €8 million additional loan to Interglass, the largest industrial glass producer in Central Asia, to complete the upgrade of the plant's facilities in Tokmok, northern Kyrgyzstan.

The largest furniture-maker in the country, Lina Ltd., raised the EBRD loan of \$650,000 to finance the purchase of new mattress-making equipment and install better ventilation in the factory to improve health and safety. The EBRD also provides the company with technical cooperation worth over \$50,000, associated with the loan, for energy efficiency and accounting improvement.

Moreover, the EBRD issued a series of loans to support banks and financial institutions in their drive to expand access to finance for micro and small business. So, the Bank boosted its support to the financial sector in the Kyrgyz Republic with two loans for a total of \$7 million to a microfinance company, Kompanion Financial Group; a \$6 million loan in local currency to Bai Tushum and Partners, one of the country's leading non-bank microfinance institutions; a second tranche of \$10 million to UniCredit Bank (formerly ATF Bank-Kyrgyzstan); a \$2 million senior loan in local currency to the micro-lending company Frontiers LLC; the first ever syndicated local currency loan in the Kyrgyz Republic for a total of \$9 million to Mol Bulak Finance non-bank microfinance institution, arranged together with FMO, the Netherlands Development Finance Company (\$6 million).

### **Islamic Development Bank**

The IsDB approved a \$23 million loan to finance the project for improvement of electric power supply in Kyrgyz cities of Bishkek and Osh.

## **Russia**

### **The World Bank Group**

IFC, a member of the World Bank Group, approved financing of five projects in Russia in 2011.

So, IFC provided two loans to Energomera Concern, including a senior loan of \$20 million for refinancing of its short-term loans and a senior loan of up to \$15 million to support the growth of company's operations in 2011.

IFC approved a local currency senior loan of up to 150 million roubles (approximately \$5 million) to Mytisch Housing and Utilities municipal unitary enterprise to support the reconstruction of the district heating infrastructure of the city of Mytisch. The project is expected to finance installation of 178 automated individual heat substations. The total project cost is estimated at 365 million roubles (approximately \$12 million). The City will fund the rest of the programme from its own sources.

Moreover, IFC provided €16.8 million in equity investment to Idavang A/S Danish holding company (previously named Danish Lithuanian Holding A/S)



for construction of a greenfield pig farm in Pskov region and development of another pig farm in northwest region, and expansion of the pig farm in Leningrad region. The total project cost is estimated at €86.5 million.

IFC approved financing of \$60 million to Russia's Transcapitalbank for energy efficiency loans to SME.

In addition, IFC and EBRD arranged a syndicated loan of \$250 million to Russia's Credit Europe Bank. IFC and EBRD each committed to a three-year A loan of \$50 million for their own account while 17 commercial banks, led by Raiffeisen Bank International, Standard Bank and VTB Deutschland, provided a one-year B loan totalling \$150 million. The pricing of the B loan is 2.5% over 3-month LIBOR. The B loan's one-year maturity can be extended for a further year at the lenders' discretion.

### **Eurasian Development Bank**

During the period under review, the EDB invested in five new projects and increased its financial support for the previously approved project in Russia.

EDB extended a loan of 2.8 billion roubles (\$100 million equivalent) to Yakutugol Holding Company for the construction of a 315-km route of the railway link from the Elga coal deposit to Baikal-Amur Mainline's Ulak station.

Moreover, the EDB provided additional \$115 million to CJSC Tikhvin Freight Car Building Plant for the construction of a high-technology production facility on the basis of the new railcar building plant.

In addition, the EDB took part in its first ever transaction arranging one-year syndicated Islamic finance for Russia's AK BARS Bank. The syndicated facility totalled \$60 million, including the EDB's share of \$20 million.

In March 2011, the EDB and the Bank BCC-Moscow signed a loan agreement for \$16 million (in rouble equivalent) for on-lending to small and medium-sized enterprises in Russia.

In the second half of 2011, the EDB increased its targeted credit facility to OJSC Bank Saint-Petersburg from \$10 million to \$25 million and extended the loan agreement for 12 months until January 2013.

The EDB took part in syndication of a \$110 million loan to Bank Zenit to finance the bank's trade operations.

### **European Bank for Reconstruction and Development**

The EBRD allocated over \$2 billion for 31 projects in Russia in 2011.

Within its largest project in Russia in 2011 the EBRD committed to provide a 10-year loan of 8 billion roubles (the equivalent of €192 million) to fund

balance sheet optimisation of OJSC Energy Systems of the Far East (ESV), RusHydro's subsidiary in Russia's Far East region. RusHydro will use the loan to refinance ESV's short-term debt as part of a major corporate restructuring which will include the unbundling of the company's electricity networks from its generation capacity.

The EBRD signed a loan agreement to provide \$155 million in long-term financing to promote environmental safety in Russian seaports as part of a drive to establish internationally competitive port infrastructure and professional port management systems in these key gateways for Russia trade. A 10-year EBRD loan to Rosmorport, the state body in charge of managing and developing Russian port infrastructure, will fund the acquisition of equipment and vessels needed to upgrade its environmental fleet, including those for collecting oil spillage and bilge water as well as those for maintenance dredging of the sea floor.

Moreover, the EBRD signed a loan agreement under which it will lend \$110 million to the country's fourth-largest non-life insurer, RESO Garantia, to support its acquisition of an equity stake in another Russian insurance company, VSK. The deal, the first such operation on the Russian insurance market, will advance the consolidation of Russia's insurance sector.

The EBRD's equity investment of up to 1.9 billion roubles in Russia's RosEvroBank gave the EBRD an 11% stake in the bank, making it the largest international minority investor in RosEvroBank.

EBRD joined a multifacility loan agreement for an amount of €750 million to finance the construction of Russia's biggest integrated polyvinyl chloride (PVC) plant in Kstovo, Nizhny Novgorod region. The financing will be provided by a group of Russian and foreign financial institutions for a period of up to 12.5 years. The project's total cost is estimated at €1.25 billion. The EBRD's contribution is an 11-year loan for the rouble equivalent of €150 million.

Moreover, the EBRD backed the establishment of a new leasing company in Russia by Deere & Company, the world's leading manufacturer of agricultural equipment. A five-year EBRD loan of up to 4.7 billion roubles (equivalent to €114 million) will support the new venture, which will also target the forestry and construction industries where renewing farm equipment is likely to account for most of the business. The loan represents the first part of a planned EBRD financing package for this project.

On June 14, 2011 the EBRD Board of Directors voted in favour of a funding increase which will boost EBRD's investments under its largest and oldest lending programme for micro and small businesses, Russia Small Business Fund (RSBF) to \$450 million. A 4.5-year extension of the fund's activities up to the end of 2015 will give the programme a chance to help bridge an enormous gap

between supply and demand in terms of micro and small business lending in Russia.

Another EBRD's important project focused on modernising district heating and water treatment systems in two Russian cities, Lipetsk and Vologda, as part of a strategy which brings the Bank's total investments in the renewal of the country's municipal infrastructure to over €750 million. The EBRD signed two 10-years loan agreements to provide a total of 778 million roubles (equivalent to €19.2 million) for infrastructure investments. Vologda is getting a loan of 467 million roubles for urgent work on its district heating network. Lipetsk will get up to 311 million roubles to renew its main wastewater treatment plant.

The Bank's investment portfolio in Russia was complemented with such diverse projects as a long-term loan of €10 million to support the post-crisis balance sheet restructuring of Mir Detstva, a leading Russian distributor and producer of branded children's goods; a purchase of a 15% equity stake in Russia's SDM-Bank for \$11.4 million (in rouble equivalent); a loan of €24 million (in rouble equivalent) to Russia's Monetka retail chain for the construction of the second phase of a modern distribution centre in Ekaterinburg, as well as the opening of a distribution centre in the northern part of the Urals; acquisition of a minority stake in Hlebprom, a leading Russian cake and biscuit producer for €10 million, and others.

### **European Investment Bank**

In the second half of 2011, the EIB extended €100 million (\$143 million equivalent) to finance the modernisation and expansion of an integrated pulp and paper mill in Syktyvkar in the Russian Federation. This is the first EIB loan provided by the Bank under the €1.5 billion Eastern Partners Facility (EPF) with a ceiling of €500 million for projects in Russia.

### **Islamic Development Bank**

Though the Russian Federation is not a member of the IsDB, the Bank provided a grant of \$370,000 from the IsDB Waqf Fund for the construction of Rashidah Islamic Institute in Kazan, Tatarstan.

## **Tajikistan**

### **Asian Development Bank**

The Asian Development Bank approved two grants for a total of \$165 million and \$1.5 million from its Technical Assistance Special Fund for improving flood risk management in Khatlon region.

ADB provided a \$120 million grant to help Tajikistan upgrade a vital road linking the capital Dushanbe with the Uzbekistan border. The grant will be sourced from the Asian Development Fund.

The ADB Board of Directors has approved the \$45 million grant assistance that will be used to support two new government pilot programmes aimed at improving the effectiveness and targeting of social benefit payments. It will also help the government push ahead with an ongoing development plan to modernise and improve tax policy and administration. The ADB grant will help the government preserve social safety net spending in the country's budget for 2011- 2012.

### **The World Bank Group**

The World Bank Group allocated \$30 million to finance three projects in Tajikistan in 2011.

IDA launched the Second Dushanbe Water Supply Project for a total amount of \$16 million equivalent to improve water utility performance and water supply services in selected areas of Dushanbe through water treatment and distribution infrastructure upgrades, metering programs and improved billing and collection systems.

In June 2011, IDA approved the Fifth Programmatic Development Policy Grant Programme (PDPG5) in the amount of \$10 million to support the government's actions in five spheres, including education, transport, agriculture, financial sector and public administration.

In December 2011, IFC and Tajikistan's State Committee on Investment and State Property Management launched the Single Electronic Registry of Tajikistan, a website for entrepreneurs that provides information on licensing procedures. The initiative was supported by Switzerland through the State Secretariat for Economic Affairs and the United Kingdom's Department for International Development. The project aims to improve the business environment in Tajikistan by removing key regulatory barriers to business entry and operations.

In May 2011, IFC provided a senior loan of up to \$4 million to CJSC AccessBank Tajikistan to finance the expansion of micro-lending in Tajikistan.

### **Eurasian Development Bank**

During the period under review the EDB approved a second financing of \$10 million to Olim-Textile for purchases of raw cotton from Tajik farming units, its processing at the spinning mill and subsequent exports of the cotton yarn.

Moreover, the EDB provided a credit facility of \$3 million to CJSC Tajprombank to finance the micro-lending programme in Tajikistan.

### **European Bank for Reconstruction and Development**

During the period under review the EBRD extended \$39.45 million equivalent for eight projects in Tajikistan. The EBRD focused on developing agriculture, banking sector, municipal infrastructure and small businesses.

After the successful refurbishment of the water supply system in the north and south of the country, the bank announced its participation in the Central Tajik Water Project, lending up to \$7 million for new clean water projects in four more cities at the request of the central government. The new EBRD loan with a sovereign guarantee to the State Unitary Enterprise "Khojagii Manziliyu Kommunalii" will be used for on-lending to water companies in Gissar, Shachrinav, Somoniyon and Tursunzoda. The project cost will be supplemented by grants. The EBRD Shareholder Special Fund has approved a grant of \$2.6 million for the project. The EU Investment Facility for Central Asia is considering a grant of €6 million (\$8.1 million) for the same project.

The EBRD provided a €7 million loan to rehabilitate the low and medium voltage distribution network of Tajikistan by equipping it with new electricity meters, meter-reading and automated billing systems. The project is co-financed by the EIB, which will make available a parallel loan of up to €7 million, and the European Union, through its Investment Facility for Central Asia (IFCA), with a possible grant of €7 million.

The EBRD extended an additional \$300,000 credit line to Makolli Bakery, a local bread and pasta manufacturer in Tajikistan, to finance its increased working capital requirements. The investment supplemented the EBRD's direct financing facility extended to Makolli in 2009, bringing the total loan amount provided to the company to \$2 million.

Moreover, the EBRD launched its new Local Currency Lending Programme in Early Transition Countries (ETC) in Tajikistan. Tajikistan became the first country to benefit from this new Programme in Central Asia. A 4-year senior loan of 13.6 million Tajik somoni (\$3 million equivalent) to Micro-lending Organisation IMON International was disbursed within the framework of the new Programme and in line with a Memorandum of Understanding signed in April 2011 between the EBRD and Tajik government. In addition, the EBRD provided another three loans within the Local Currency Lending Programme in Tajikistan, including a loan of \$6 million to Accessbank; a syndicated loan to Bank Eshkhat (\$2 million from EBRD's own funds and \$6 million syndicated to commercial banks); and a lending facility of up to \$4 million (equivalent) to First MicroFinance Bank Tajikistan.

### **Islamic Development Bank**

The IsDB provided two grants for a total of \$4.3 million. One of the grants in the amount of \$2.2 million was allocated to finance the construction and technical equipment of a modern general education school in the village Zarkamar, Jamoat Miskinobod, Faizobod district. The second grant of \$2.1 million was provided for the water supply project in Dushanbe.

In addition, the IsDB signed an agreement with the National Bank of Tajikistan to provide technical assistance on the formulation of legal, regulatory and administrative base for developing Islamic banking in the country.

## **Turkmenistan**

### **Asian Development Bank**

During the period under review the Asian Development Bank provided a technical assistance grant of \$1.3 million to Turkmenistan for the preparation of documents on Afghanistan and Turkmenistan: Regional Power Interconnection Project, which is expected to be approved by the Board in 2012. The estimated amount of financing may make up \$100 million.

ADB provided \$125 million in a loan to Turkmenistan for improving its railway network. The financing will be used to fund power, signaling, and telecommunication systems on a 311 km stretch of the 934-km long North-South Railway Corridor. The line will improve Turkmenistan's access to neighbouring Kazakhstan, as well as Persian Gulf Countries, the Russian Federation and South Asia. The loan from ordinary capital resources will make up 75% of the total project cost of \$166.7 million. The loan will have a 25-year term, with a five-year grace period.

### **The World Bank Group**

The WB didn't finance any projects in Turkmenistan in 2011.

### **European Bank for Reconstruction and Development**

The EBRD financed two projects in Turkmenistan for a total of \$3.6 million equivalent, including the loan to a printing services company, Intek Media, for a technological upgrade; and a loan to a private construction services company, Shazada, for the purchase of new heavy machinery and trucks.

### **Islamic Development Bank**

The IsDB provided a special investment loan to Turkmen government in the amount of \$121.17 million for improving the quality of water supply services within the Balkan Velayat Water Supply Project.

## **Uzbekistan**

### **Asian Development Bank**

The Asian Development Bank approved 13 projects for a total amount of \$988.87 million in Uzbekistan in 2011, including a number of multitranche financing facilities for major projects in transport and social spheres.

In its first private sector operation undertaken in Uzbekistan, ADB invested \$8 million in equity capital of two private banks, Ipak Yuli Bank and Hamkor Bank.

The loan of \$100 million to LUKOIL Overseas Uzbekistan Ltd. is to finance development of the Kandym gas field.

The ADB Board of Directors has approved a \$240 million loan to Uzbekistan within the CAREC Corridor 2 Road Investment Programme multitranche financing facility. Moreover, the multitranche financing facility for the Second CAREC Corridor 2 Road Investment Programme has also been approved. The first tranche of \$130 million will be used to rehabilitate a 74-km section of A373 highway running through the Fergana Valley. In addition, ADB extended a \$100 million loan for the Railway Electrification Project which will finance the electrification of a 140-km stretch of rail line between Marakand in Samarkand province and Karshi in Kashkadarya province. The railway is part of the Central Asia Regional Economic Cooperation Corridor 6.

In June 2011, the ADB Board of Directors approved the multitranche financing facility for the Housing for Integrated Rural Development Investment Programme, with a first tranche payment of \$200 million. The Programme will help to strengthen the impact of the government's Rural Housing Scheme (RHS) to improve rural livelihoods and living standards. In the medium term it will increase the capacity of local government staff to prepare and carry out effective rural development and investment promotion plans, and support policy reforms that will accelerate private sector development and the establishment of micro and small rural businesses.

ADB has also approved three projects in the field of energy, including a loan of \$150 million for the installation of modern, accurate, theft-proof digital meters for one million residential and small commercial power users in the cities of Bukhara, Jizzakh and Samarkand. The meters will operate using an automated management system that makes it possible to cut distribution losses and boost Tajikistan's energy efficiency. The technical assistance grant of \$225,000 was allocated for the preparation of the Design and Strengthening of the Solar Energy Institute project. Another technical assistance grant in the amount of \$1.5 million was provided for boosting the development of solar energy in Uzbekistan and attracting investments in the field.

A third tranche worth \$58 million was allocated to implement a programme to modernise water supply in Karakalpakstan autonomous republic (the cities of Jizzakh and Khorezm), as well as to restore waste water systems of Andizhan.

### **The World Bank Group**

The WB Group approved the allocation of \$291 million to Uzbekistan in 2011, including the \$93 million IDA credit for Uzbekistan's Health System Improvement Project; the \$110 million IBRD loan for Talimarjan Transmission Project; and the \$88 million IDA credit for the Syrdarya Water Supply Project.

## Islamic Development Bank

The IsDB didn't finance any projects in Uzbekistan in 2011.

## Ukraine

### The World Bank Group

Within the framework of the Second Export Development Project (EDP2) the WB approved the additional financing of \$150 million IBRD loan to the State Export-Import Bank of Ukraine (Ukreximbank) to support export-import operations of Ukrainian exporters. Moreover, Ukreximbank raised a \$200 million loan for the Energy Efficiency Project.

Ukraine became the only country to win the WB grant at the second meeting of PMR Assembly on October 27-28, 2011 in Istanbul: Ukraine received a grant of \$5.35 million within the framework of the Partnership for Market Readiness (PMR).

Together with several banks IFC arranged a financing package to support major Ukrainian petrol station operator Galnaftogaz. IFC and the EBRD provided two \$65 million corporate loans each, with sub-participations by ING Bank and FMO, the Netherlands Development Finance Company, of \$30 million each. The Black Sea Trade and Development Bank (BSTDB) will provide a parallel corporate loan of \$30 million. In addition, the EBRD will invest \$30 million of equity in Galnaftogaz equity. The financing package will help acquire or construct up to 75 filling stations, thus bringing Galnaftogaz network of filling stations to over 380 across the country.

### European Bank for Reconstruction and Development

During the period under review, the EBRD extended \$1.16 billion equivalent for 19 projects in Ukraine.

The EBRD provided a €200 million 15-year sovereign loan to Ukgidroenergo (UHE), Ukraine's state-owned operator of large hydro generating and pump storage facilities. This is the largest renewable energy project financed by the Bank in Ukraine to date, which will see the upgrades of hydro- and electro-mechanical equipment at UHE's hydropower plants. The EBRD loan is part of a larger project which envisages similar-sized parallel financing from the European Investment Bank. Technical cooperation funds for the project were provided by the EU Neighbourhood Investment Facility and the UK government.

The Bank approved four projects in the agricultural sector for a total amount of \$135 million equivalent.

Together with IFC the EBRD took part in arranging a financing package to Galnaftogaz, and joined forces with the EIB and Ukraine's national oil and gas



company, NAK Naftogaz, to finance the modernisation of the country's Soviet-era gas transportation system (\$154 million).

The Bank took part in three projects in the production and services sector and provided a total of \$95 million.

Moreover, the EBRD approved two projects for \$58 million in the field of developing transport and transport infrastructure.

The EBRD launched a \$100 million lending facility for micro, small and medium-sized enterprises in Ukraine to support the development of new loan products, including rural and agricultural lending through local commercial banks. Credit Europe Bank Ukraine (CEB) became the first bank to use the facility through a \$10 million loan.

### **European Investment Bank**

In 2011, the EIB approved financing of two projects in Ukraine for a total amount of \$404.5 million, including a joint EIB-EBRD project for modernisation of Ukraine's gas transportation system with the EIB participation of \$154 million, and a loan of \$250.5 million to Ukrenergo, Ukraine's National Power Company, to optimise the use of existing electricity generation capacity.

# Information for authors

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Khristenko V.B. (2004) Making Headway to Integration. *Russia in global politics*. 2 (March-April). Available at: <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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Requirements for submissions. Papers should be sent by e-mail to [editor@eabr.org](mailto: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.

### **EDB Eurasian Integration Yearbook**

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).

### **Industry Reports**

The EDB's Analytical Department publishes industry and country reports. Electronic versions are available at <http://www.eabr.org/rus/publications/AnalyticalReports/>. To date, these reviews include:

### **Consulting services**

The Bank provides consultancy services to its strategic partners and clients. The Bank's Strategy and Research Department has in-house expert resources and can involve specialists from other departments, such as project managers, corporate financing, treasury, legal department. External experts from the extensive pool of CIS countries' experts could be mobilised to work on consultancy projects.

### **Areas of expertise:**

- Analysis of current status and dynamics of development in selected sectors in the member states of the Bank and other EurAsEC countries;
- Financial markets analytical reviews in the EurAsEC countries;
- Economic and legal analysis of integration agreements and institutions in the Eurasian space;
- Development banks' operations and activities in the CIS countries and issues of cooperation.

### **Contacts**

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## Report no.1

### UKRAINE AND THE CUSTOMS UNION

Comprehensive assessment of the macroeconomic effects of various forms of deep economic integration of Ukraine and the member states of the Customs Union and the Common Economic Space

The authors of the report indicate that ongoing development of the largest economies within the post-Soviet area (Russia, Ukraine, Belarus, and Kazakhstan) is associated with structural change, whereas the potential for significant economic growth based on raw exports and outdated manufacturing industries is nearing exhaustion. For the first time in the last 20 years, the study formulates an inter-industry set of analytical-forecasting models for the region's four leading countries. The notable merit of the work lies in the fact that it applies a single methodology to its inter-industry analysis. Taking such an approach has allowed the authors to model common economic dynamics and structural changes, as well as to obtain sound assessments of possible integration scenarios throughout the post-Soviet area.

*Available in Russian and English*



## Report no.2

### STUDIES OF REGIONAL INTEGRATION IN THE CIS AND IN CENTRAL ASIA: A LITERATURE SURVEY

This work by Alexander Libman represents a high-quality and detailed critical review of the research literature on post-Soviet integration that has been published in the last 20 years. Being affiliated with research institutions in Frankfurt am Maine, Moscow and Shanghai, the author of the review is a reputed and active researcher of post-Soviet integration.

He tries to look at the subject from both the outside and the inside, which is especially important in the context of the work. The author analysed the major trends of research of the regional integration processes in the post-Soviet region and Central Asia that have been carried out by both the Russian and international academic communities.

*Available in Russian and English*



## Report no.4

### EDB INTEGRATION BAROMETER 2012

The report presents the results of a comprehensive research study of public attitudes towards integration in the post-Soviet space. The report is based on monitoring surveys of public opinion in former Soviet Union countries on a diverse range of issues, such as multilateral economic cooperation, interstate political relations, social and business contacts and cultural interactions. A detailed picture of public attitudes, including the dynamics, fundamental regularities and forecasts of future developments in integration processes, as well as public evaluation of the degree of integration between the post-Soviet countries are presented in the report.

Given the importance of the long-term forecasting regarding public perception of integration processes in the region in question, it is supposed to conduct annual research within the EDB Integration Barometer project. In future, the project can also be supplemented with the study of integration preferences of the business elite.

*Available in Russian and English*



## Sector Reports

### INTEGRATION PROCESSES IN THE ELECTRIC POWER SECTORS OF THE EDB MEMBER STATES

The objective of this sector report no.15 is to study integration processes in the electric power sectors of the EDB member states: the Republic of Armenia, the Republic of Belarus, the Republic of Kazakhstan, the Kyrgyz Republic, the Russian Federation, and the Republic of Tajikistan.

The report analyses the power sectors, in particular, changes that have occurred in recent years, key trends in the development of generating capacities and power grids, and electricity exports and imports. It also examines the main challenges to development and the key drivers of electricity demand. The report studies power transit and cross-border trade in electricity, system effects of the national power systems' integration, mutual investment in the power sector, and supplies of power-generating and electrical equipment. In addition, the report analyses joint interstate initiatives, including the future establishment of a common electric power market, and examine possibilities of introducing uniform technical and environmental standards and a legal framework, regulating the common market. Recommendations are provided on how to deepen integration in the region and foster the creation of the common electric power space, with an emphasis on the EDB's role in this process.

*Available in Russian and English*

## Analytical Reports

### THE SAFETY OF HYDROWORKS IN CENTRAL ASIA: PROBLEMS AND APPROACHES

This analytical report was prepared by a group of experts of the Executive Committee of the International Fund for saving the Aral Sea (EC IFAS) based on a regional report on the same subject and with technical assistance from the Eurasian Development Bank.

Hydroworks are necessary for the comprehensive use of water resources, including drinking, industrial and agricultural water supply; irrigation, hydropower, fishery, navigation, recreation, and ecosystems maintenance. Central Asian hydroworks that have a direct bearing on infrastructure development bring multiple benefits and ultimately foster regional development. This paper is a contribution to the future development and improvement of national rules, laws and technical documents, personnel training, exchange of expertise, and long-term cooperation between Central Asian states in hydroworks safety on a regional footing.

*Available in Russian and English*

## Monographs

### PRIORITIES OF COOPERATION IN TRANSBOUNDARY RIVER BASINS OF CENTRAL ASIA

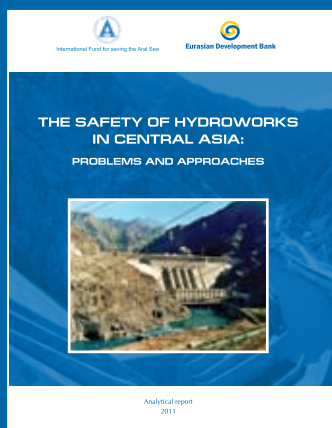
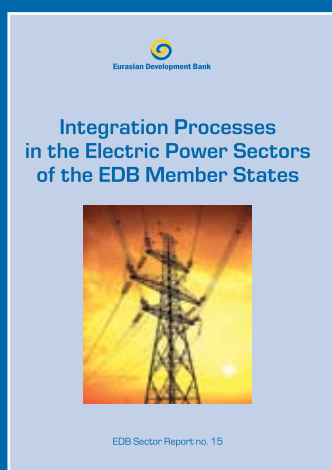
V. Yasinsky, A. Mironenkov, T. Sarsembekov (2012)

The natural and geographical conditions of Central Asia give rise to the unique character of the formation of run-off within the river basin, just as political and economic realities dictate its use. The state of the region, whose countries have no access to the sea, entails the necessity of expanding trade-and-economic relations and the strengthening of integration processes. In order to adapt to the changing hydrological systems of transboundary rivers so as to ensure a sustainable and reliable system of interstate water management, there must be improved access to hydrological and hydrometeorological information, including access to the rapid exchange of that information between the countries in the region. One of the priorities of regional cooperation should be the enhancement of capacity and readiness to respond to the impact of climate change and hydrological changes.

The principles of basin management are becoming a major feature of cooperation between Central Asian countries in transboundary river basins, thus bringing together the interests of each state in the region within the river basin on the basis of generally accepted international and legal norms concerning the common use of transboundary water flows. This book presents interest to researchers, specialists, and be a valuable tool for students. Its relevance is also related with the UN International Decade «Water for Life» (2005–2015), the achievement targets of which is essential for the sustainable development of Central Asia.

*Available in Russian and English*

All publications available at:  
<http://www.eabr.org/e/research/>







## 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.

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. Tajikistan, Belarus, Armenia and Kyrgyzstan joined the Bank in 2009-2011.

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