



**THREATS OF EURASIAN
CUSTOMS UNION ON THE WAY
TO EUROPEAN INTEGRATION
GEORGIAN PERSPECTIVE**



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CONTENT

Historical Context	5
Economic Aspects of the Union	6
ECU vs. other trade preferences	8
1. Most Favored Nation	8
2. Generalized System of Preferences – (GSP).....	8
3. GSP +	8
4. Free Trade Agreement.....	9
ECU – Georgian Perspective	9
References	14



HISTORICAL CONTEXT

The history of Eurasian Customs Union (ECU) dates back to 1995, when Russia signed a treaty on the formation of a customs union with Belarus and Kazakhstan (later joined by Tajikistan in 1997). In 2000 the grouping was transformed into an international organization Eurasian Economic Community (EEC). Unlike Commonwealth of Independent States (CIS), EEC aimed at binding its signatories to an agreement by seeking to coordinate ratification and prohibit reservations, at the same time a permanent executive International Council was created. A special court was to be set up for improved dispute settlement. It is important to stress that Russia was viewed as a future center for gravity. Planned trade and customs integration ended up to be limited, since the EEC member states still exercised special trade measures and quotas. That is why an idea of creating a common Customs Union (CU) emerged. A treaty on setting up the customs union was signed in October 2007. The three members established a Customs Union Commission, as of July 2010 a key document Customs Union Code entered into force. In July 2011 the elimination of the international physical border control was announced [1].

As of January 2012 the customs union was transformed into a deeper integration and presents a single economic space. Officially called ECU in the framework of Eurasian Economic Development – name of this Union mainly has an economic connotation to it. However, everyone agrees that its main goal is political. Current as well as future spheres of competence of the union prove this argument. The Union aims to achieve the following:

1. Cooperation in the defense sector among the member states on the basis of the Collective Security Treaty Organization (CSTO). Creation of common military and police forces for internal conflict resolution. The defense center of the Union is Moscow.
2. Common Parliament and Executive bodies;
3. Common currency by 2022 (most probably Russian Ruble);
4. Coordinating foreign policy with Russian Federation;
5. Common Educational Space;
6. Common Banking Space;
7. Common Customs and Economic Space.

ECU together with the notion of single economic space will fully enter into force on January 1st, 2015 [1]. The union has already implemented its Common External Tariff (CET) [2], while internal border controls were removed between Belarus and Russia and then between Russia and Kazakhstan. This meant small external tariff declines for Russia and Belarus, and a drastic increase for Kazakhstan. Furthermore ECU has determined rules regarding sanitary and phytosanitary measures for exports and imports from the three countries [3].

Since the break-up of the Soviet Union a number of initiatives have been launched so to say to re-integrate the new independent states, unlike many others ECU is considered to have a more robust institutional structure and is consistent with the World Trade Organization (WTO) regime and modern institutional norms. Moreover, major emphasis is placed on economic benefits of the union rather than “shared values and history” as was the case in previous initiatives. The framework is modeled on EU and represents an alternative to its European Neighborhood Policy European Action Plan – ENP EaP [1]. Even though emphasis is placed on the sustainable economic benefits for the member countries, economic outcomes of the Union are questionable and have been an issue of debate among many researchers.

ECONOMIC ASPECTS OF THE UNION

Due to the profile of our organization – Economic Policy Research Center, we will place emphasis on the economic aspects of the Union. Today, supporters of the Eurasian Union stress economic benefits of the membership. That is, benefits that the Russian market will bring to the Georgian production by increased export potential and thus to economic development. We will analyze the expectations and real perspectives in further details:

As of today, ECU is a form of economic integration of Belarus, Kazakhstan and Russia. As mentioned, it envisages creation of a **“common customs space, without export taxes and economic limitations among the member states”**. However, **“member countries can apply special protective, anti-dumping and compensation activities when needed.”** This means that despite its achievements and expansions the union is not yet considered to be truly a genuine customs union, since members still have protectionist barriers, and allow exceptions to the rules [3].

It is noteworthy, that Georgia was still a member of Commonwealth of Independent States (CIS) (the country officially left CIS in 2008 after the war), when an economic embargo went into force in 2006. Moreover, this embargo was associated with the food safety measures. This is a good example to realize that membership of the Eurasian Union is no guarantee that Georgian production will not become part of the “special protective” sanctions, as written in the Union’s documentation. Moreover, we believe that these types of exceptions are envisaged for countries like Georgia. Especially if we take into account the fact that CU commission is responsible for making decisions in ECU. The votes are weighted so that Russia has 57%, Belarus and Kazakhstan 21.5% each. This means that formally Russia always needs to agree with at least one other member, yet even if Belarus and Kazakhstan act jointly, their votes are still unable to outweigh Russia’s. In other words ECU is seen as a vehicle for Russia to reintegrate the post-soviet space including the countries that fall under the EU’s eastern neighborhood [2]. This statement is further proved by the fact that ECU membership does not require any political conditions: all post-soviet-countries regardless of their political regimes are welcome to join.



From 2010 to 2011 trade between the three member states (Russia, Kazakhstan and Belarus) increased considerably. However, this increase was mainly reflected in two major economies – Kazakhstan and Russia. Kazakhstan's imports from Russia grew by over two-thirds from 2009 to 2011 and exports more than doubled during this period. Part of this growth might be attributed to the post-crisis recovery from the global crisis [3]. Although we believe that given the size and strength of these two central economies, Georgia might not be one of the beneficiaries of the union. According to EBRD, the CU appears to have had tariff-related trade creation effects for Russia only [4].

Besides, Georgia will have to give preference to importing production from Russia and other member states; majority of these goods are currently substituted by Turkish and Chinese ones. As a result competition will be distorted in Georgia, followed by an increase in prices and a decrease in the quality of production available. Prices for the products coming from non-member states might become inadequately expensive due to differences in customs regimes. Therefore, we will face a situation similar to the one in Soviet Union when the population of Georgia will have to choose among production from Russia or other Eurasian member states, and extremely expensive goods imported from other countries.

This perspective might not sound feasible in the 21st century, especially when both Georgia and Russia are members of WTO. A good example is the case of Belarus and Kazakhstan – these countries were forced to raise their import tariffs for cars from 5 to 15 percent, and as a result bought more cars produced in Russia than before. Moreover, the perspective might not be so unreal after all, especially when going through the Union regulations:

“Members of the Union use the same tariffs and regulations when trading with third countries”.

Analysis of trade flows among the member states conducted by EBRD has shown that tariff policy had a fairly limited impact on trade flows to the members of the Customs Union. Tariff increases to other trade partners had significant negative effects on trade between CU members and other trade partners. These effects were mostly marked for trade from China, and less from the EU countries [4] [5]. Thus, CU causes trade diversion to some degree which is not economically and politically profitable.

The Center for Economic and Social Development (CESD) of Azerbaijan believes that notwithstanding economic benefits that Azerbaijan might enjoy in ECU, there are substantial political and economic disadvantages associated with accession. Researchers believe that tariffs and trade barriers might be lowered by the government of Azerbaijan without entering ECU, which will still foster foreign trade and bring similar economic benefits to the country. While the experts of the center also note that Russia has a large political tools to influence Azerbaijan, especially through forbidding Azeri nationals (unofficially around 2 million) to work and do business in Russia. The latter might be the treat used by Russia to force Azerbaijan into the Union. In such a case the country might be facing loss of trade links with EU and Turkey especially in energy issues [6] [7]. Experts believe that Armenia was also forcefully made to express consent to joining the Union. We shall elaborate on the issue later on in the paper.

ECU VS. OTHER TRADE PREFERENCES

By joining the ECU Georgia might have to say no to the acquired preferences on the world markets, or the ones that are yet to be acquired such as the Deep and Comprehensive Free Trade Agreement (DCFTA). Placing member countries on equal conditions is a request from the ECU and on the other hand a prerequisite of the EU. That is membership of the Union is not compatible with the European integration process.

Since we place emphasis on the economic feasibility/reasonability, below we briefly discuss those trade regimes/preferences that Georgia currently enjoys [8] and that might be jeopardized by entering the Eurasian Customs Union:

1. MOST FAVORED NATION

Majority of Georgia's trade partners are members of WTO and therefore trade relations with those 153 countries are based on the principles of "most favored nation regime" (MFN). It means that countries eligible for this regime must receive equal trade advantages and not have discriminative treatment in trade. However, exceptions from MFN are allowed in case of an agreement on the creation of a customs union, or a free trade/regional trade agreements. This means that ECU is fully compatible with WTO standards as discussed in the paper.

2. GENERALIZED SYSTEM OF PREFERENCES – (GSP)

The main idea of this preference is that developed countries assist less developed countries in promoting their exports. Essence of GSP is low import tariff to the beneficiary countries that will foster access of the developing countries to the markets of the developed countries. Georgia has been granted GSP treatment by the following countries: the EU, the USA, Japan, Canada, Switzerland and Norway. The US preferential scheme covers wide range of products, including Georgia's most important export products such as: walnuts, dried fruit, mineral waters, beer, some sorts of wine, copper, ferroalloys, etc.

3. GSP +

Since July 2005, Georgia enjoys a GSP + trade regime with EU; In case of GSP 3300 types of products were covered to enter the EU market duty free and in the framework of GSP+ up to 7200 types of Georgian products can enter EU market with zero customs tax. This is an important step forward in promoting Georgian exports.



4. FREE TRADE AGREEMENT

Georgia has free trade agreements (FTA) with CIS countries (including Russia) and Turkey. Since 1994 Georgia enjoys free trade regimes with CIS countries which mean that goods and services are exempt from import customs duties. Therefore, it can be considered that preferences that ECU offers in terms of trade are more or less already enjoyed by Georgia. However, as mentioned, notwithstanding the free trade regimes, Russia still placed embargo on Georgian products in 2006, that has been partially lifted in 2013.

FTA with Turkey has been signed in 2008. Customs duties on the import of industrial products have been fully cancelled, with special exceptions on agricultural products from both countries.

Entering the Eurasian Customs Union will at minimum jeopardize the free trade agreement that the country enjoys with Turkey. Turkish market will no longer be accessible for Georgia on the old terms.

It should be noted that Georgia is unable to use many of the benefits and preferential treatments as of today. However, the potential is huge and in case of correct approach these preferences can be used for economic development of the country.

ECU – GEORGIAN PERSPECTIVE

Will the Eurasian Customs Union be able to outweigh the benefits that Georgia currently enjoys or will have in the nearest future? How beneficial will even opening of the Russian market be for Georgia?

In case the country signs DCFTA Georgia will be able to export goods and services to the EU market, the country will develop trade related mechanisms. As part of the Association Agreement DCFTA ensures that trade is liberalized to the fullest extent possible. Moreover, it is something more than a normal free trade agreement, it concerns not only trade liberalization in all areas, but rather harmonization of partner countries' trade-related legislation with EU standards [9]. These include regulatory disciplines that aim to ensure a stable and growth-oriented policy framework that will boost competitiveness. Such as improvement in transparency and competition provisions, as well as intellectual property rights. Therefore, taking advantage of the EU market will take place in terms of increased FDI inflows from EU countries that will modernize the economy, infrastructure and create more jobs.

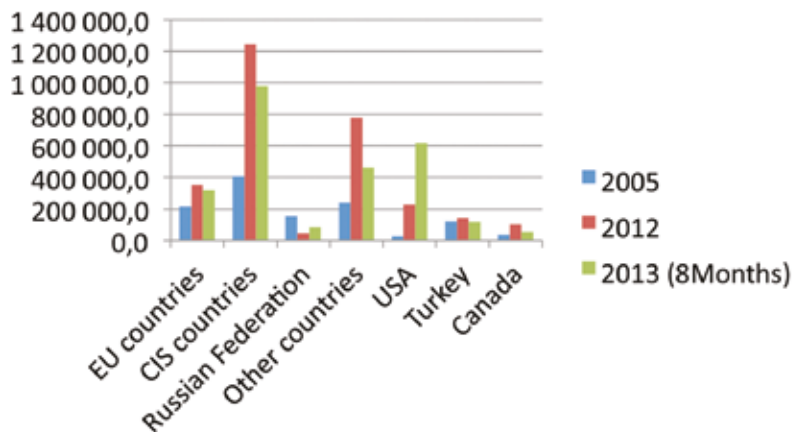
Free, stable and predictable environment will be fostered, thus increasing FDI from European countries. Entering the common European economic space will place Georgian goods on the same terms as local, European products. For this to happen, Georgian products have to satisfy strict European requirements, which is a hard and lengthy process, however ultimately will increase the quality of goods produced in the country and hence their export potential. Moreover, Georgia will be more focused on food safety and consumer protection aspects. The European market counts about 500 million consumers with average annual income of 39,000 USD, and has a GDP of over 16 trillion Euros. It is forecasted that in case of signing the DCFTA Georgian exports to EU will increase at minimum by 12%, while imports from EU by 7.5%. Georgia's GDP is predicted to increase by 4.3% or 292 million Euro in the long term provided that DCFTA is implemented and later on sustained efficiently [10].

Various studies based on the computable general equilibrium (CGE) models have been conducted on assessment of the effects on countries' economies in case of accession to the ECU vs. DCFTA. CGE was conducted on Ukrainian economy of Ukraine's accession to the ECU vs. implementation of the DCFTA. According to these studies, DCFTA would add 11.8 percent to Ukraine's GDP, while the CU would reduce it by 3.7 percent [11]. DCFTA would radically increase trade in terms of both exports and imports, while the ECU would reduce overall trade turnover. The biggest impact comes from exports - expected long term gains in Ukrainian exports to all countries under the CU equal 17.9 percent, while under the EU scenario 46.1 percent [12].

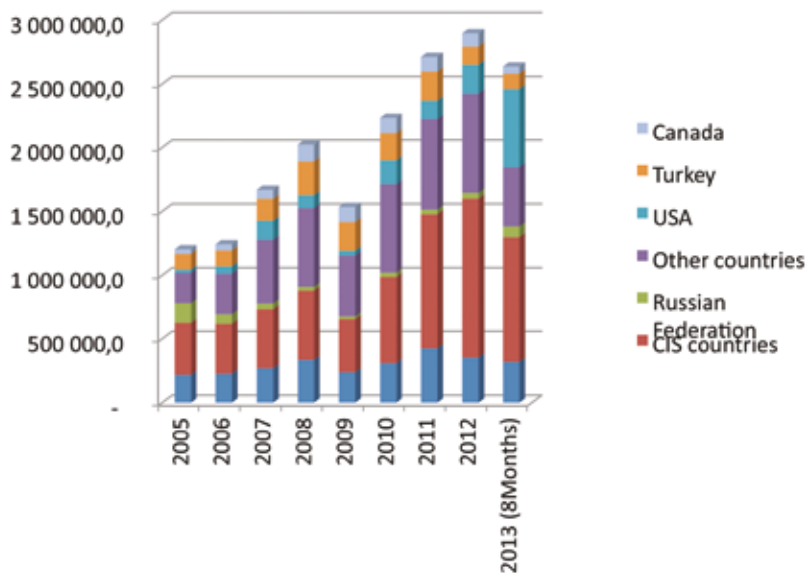
It is noteworthy that the EU is providing substantial assistance in regards to DCFTA related reforms. Georgia has received 31 million Euro assistance in 2011-2013 and will be eligible for future significant assistance devoted to implementing reforms for meeting DCFTA requirements in 2014-2020 [9].

However, a wrong perception is set by the Russian government that ECU will join the dialogue with the EU. Apart from bringing economic benefits ECU is claimed to facilitate EU integration of the member countries. This statement is far from reality, since the EU has already expressed and stated that ECU and EU integration are not compatible with each other it is an either or choice.

In 2005, before the embargo of the Russian Federation, when Georgia was still the member of CIS, export of Georgia to EU countries considerably exceeded export of Georgia to Russian Federation. That is export in monetary terms to EU countries was 216 million USD, while export to Russia only 153 million USD. Georgian exports to Turkey, a major trade partner, were slightly less than those to Russia. It is worthy to note that after the Russian embargo as of today, Georgian export to CIS countries has increased fourfold - from 241 million to 778 million and is more than before embargo Russian export volume 5 times. See charts below



This means that Georgia managed to diversify its markets, find new ones, increase production and degree of competitiveness. These figures give us an overall idea of what Georgia might lose if it chooses Eurasian Customs Union membership over European Integration and plays by the rules set by Russia. Georgia will get the Russian market with the rules set by Russia and will lose all achievements and progress it has done in the past decade on the international market, together with financial and economic independence.



Trade with ECU countries: Belarus, Russia and Kazakhstan represented 10 percent of total exports of Georgia in 2012, the share has remained the same as of three quarters in 2013, 50% out of the total exports to these three destination countries falls on Russia as of 2013. None of the ECU member countries are top 5 export partners for Georgia, the list is as follows: Azerbaijan 26%, Armenia 11%, Turkey 7%, USA and Ukraine 6%. Similar statistics hold true for Georgian imports, out of the three member countries Russia leads with 70% of total imports to Georgia, and makes it to top 5 of import partner countries. The list includes Turkey with 17%, Ukraine, Azerbaijan and China with 8% [13].

On the other hand, EU is one of the largest trade partners of Georgia and accounts for 27% of trade turnover, on average 2.8 billion USD annually. On average annual exports account for 400 billion USD and account for 15-16% of Georgia's total exports. Average annual imports equal 2.4 billion USD and comprises 29-31% of total imports [10]. Main export products to EU include: hazelnuts, walnuts, wine, mineral waters, spirits, fruit and vegetable juices, non-alcoholic beverages, mineral fertilizers, scrap metal, etc. These figures have strong growth perspective after DCFTA comes into force.

As a matter of fact ECU is not beneficial for the participant countries, the mere fact that Russia pays Belarus and Kazakhstan for the sacrifices they have made by joining the Union, once again highlights the fact that the union has a strong political connotation to it. Belarus receives oil and gas subsidies of 15 to 18 percent of its GDP from Russia. During a payment crisis in 2011, Russia offered a bailout package of 20 USD billion for three years. Kazakhstan is not enthusiastic about the ECU either. It meant trade diversion for this country. Kazakhstan was forced to raise its average custom tariffs from 6.7 to 11.1 percent on an unweighted basis and from 5.3 to 9.5 percent on a trade-weighted basis, according to the World Bank the cost of Kazakhstan joining the Union in its baseline scenario is 0.2 percent of GDP [11]. After Russia's accession to WTO, Belarus and Kazakhstan started to complain that Russia's WTO obligations were applied to them as well. The above mentioned makes Georgia's potential benefits from membership even more vague.

It is important to note that together with Georgia, Armenia also completed negotiations with the EU on the association Agreement and DCFTA. However, due to the Russian pressure on Armenia, and Ukraine's determined resistance to join the ECU, the government of Armenia made a political statement regarding Armenia's readiness to join the ECU. Practically speaking, a custom's area is appropriate only for states that have a common border. Therefore, Armenia could only join the Union by the way of Georgia (since its borders with Armenia are closed) [14]. The latter argument increases strategic importance of Georgia to enter the Union. Russia is also unwilling to let Ukraine integrate in the euro zone and launched trade sanctions against the country in July and August 2013. Russia wants Ukraine to join its ECU, Russian officials are even threatening Ukraine to tighten customs procedures [11].

Lastly, ECU is a trade and economic union based on geographical area. Limiting trade by geographical area will not be profitable in any case. The EU and other countries of WTO represent far better opportunities for Georgia. From



economic viewpoint, entering a more limited economic space and strict trade regimes is nonsense, especially in the conditions of globalization. Self-isolation will not be the chose to be made for a country like Georgia that is currently integrated in the world trade. There have been a number of studies conducted on the economic benefits of ECU in a study by Vinhas de Souza (2011) it is stated that ECU is a GDP reducing framework that has more negative trade-diversion effects than positive trade-creation ones. Thus, ECU causes trade diversion to some degree which is not economically and politically profitable.

Moreover, the Union is considered to be an attempt of re-integration of FSU countries under the Moscow influence. From an economic viewpoint the Union is also problematic because of various economic interest and structures of the participant countries. For example Kazakhstan is a raw material exporter, Belarus exports soviet-style manufactured goods, while Russia has a protectionist role. Moreover, as mentioned ECU has problems of compatibility with third parties, and especially it jeopardizes Georgia's will towards European Integration, since the Union is not compatible with DCFTA prerequisites.

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