
Kazakhstan and Eurasian Economic Integration: Quick Start, Mixed Results and Uncertain Future



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November 2012

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Centre Russie/NEI
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ISBN : 978-2-36567-101-9

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Related Previous Publications

- “Kazakhstan: Constructing Identity in a Post-Soviet Society” (with Scott Spehr), *Asian Ethnicity*, Volume 13, Issue 2, 2012;
- “Promises and Hurdles in EU-Kazakhstan Energy Cooperation”, *EUCAM Commentary*, November 2011;
- (“EU-Central Asia Bilateral Cooperation” in *The European Union in Central Asia*, edited by A. Warkotch, Routledge Taylor & Francis, 2010;
- “Central Asian Regional Security Cooperation: Constraints and Prospects” in *Security Sector Reform in Central Asia: Exploring Needs and Possibilities*, edited by M. Hartog, Greenwood Papers, Groningen: The Centre for European Security Studies (CESS), 2010.

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Executive Summary

Kazakhstan's economic integration with Russia and Belarus has been advancing at break-neck speed. In October 2007, these countries signed a treaty on the creation of the Customs Union (CU), in July 2010 the unified Customs Code went into effect, and in July 2011 customs controls were removed from the borders between member-states. In January 2012, Moscow, Astana and Minsk took another big leap and introduced the Single Economic Space (SES) based on "freedoms" of movement of goods, services, capital and labor to be implemented by 2015.

The creation of the CU and SES constitutes a major breakthrough for Eurasian economic integration project, promoted by Kazakhstani President Nursultan Nazarbayev since early 1990s. While a union with Russia has been always an official priority, other trade integration alternatives have been pursued by the Kazakhstani government as well. The one that was in strong competition with the CU option was the prospect of joining the WTO and this way advancing Kazakhstan's integration with global markets and making the country's economy more competitive. The tension between these two options remained till 2009, when the decision was made to join the CU first.

The analysis of the possible motives (economic, political and geopolitical) explaining why Kazakhstani leadership privileged integration with Russia over joining the WTO shows that economic reasons emphasized in the official discourse did not play the main role. Political reasons (primarily, the concern with security) seem to have been more prominent.

An overview of the CU's results shows that they have been mixed at best, despite the continued enthusiasm of government officials. The introduction of higher external tariffs hurt Kazakhstani producers (except for exporters of minerals and metals) and consumers, while the opening of the customs borders did not result in major growth of Kazakhstani exports to CU member-states. It remains to be seen on what conditions Kazakhstan will be joining the WTO, and whether this can partially alleviate the negative impact of the CU.

As for the political impact, the Eurasian integration project allowed the mobilization of nationalist forces around the issue and gave them a strong argument in opposing the government. The inflation stimulated by the CU, increased the potential of instability in the country. The fact that Eurasian integration is promoted largely by

the political will of the member-state presidents, and there is lack of public consensus regarding the usefulness of the CU, SES and future Eurasian Economic Union, the sustainability of the project is not ensured.

In geopolitical terms, the formation of the CU and SES has not affected noticeably the traditional multi-vector foreign policy of Kazakhstan. The lack of internal dynamism and resources of the Eurasian economic integration project means that it does not constitute a major challenge to Europe and China, two of Kazakhstan's major trade partners. However, it does, to some extent, re-establish the traditional role of Russia as a "window to Europe."

The CU created a bigger challenge for Kazakhstan's Central Asian neighbors, particularly Kyrgyzstan. To fulfill its obligations toward CU partners, Kazakhstan strengthened its southern borders and introduced stricter trade regimes. Unless Kyrgyzstan and Tajikistan are engaged in the integration project, as promised by Presidents Putin and Nazarbayev, the development of the SES would mean further fragmentation of the Central Asian region. Such integration, however, seems unlikely in the near future due to the serious challenges that it would entail.

An earlier version of this paper was presented at a conference organized by Ifri in the framework of the Eurasian Trade Task Force (ETTF). The ETTF addresses the different commercial and economic integration projects in Eurasia and their impact on domestic and foreign policies of the states concerned.

Introduction

Kazakhstan's economic integration with Russia and Belarus has been advancing at break-neck speed. In October 2007, these countries signed a treaty on the creation of the Customs Union (CU), in July 2010 the unified Customs Code went into effect, and in July 2011 customs controls were removed from the borders between member-states. In January 2012, Moscow, Astana and Minsk took another big leap and introduced the Single Economic Space (SES) based on "freedoms" of movement of goods, services, capital and labor to be implemented by 2015. For comparison, it took European countries 10 years to transform the free trade zone into a customs union and 19 years to move toward the common market.

Eurasian economic integration has always been the official priority of Kazakhstan's government, and therefore membership in the newly created CU and SES together with Russia and Belarus seems to be the logical outcome of a consistent policy. However, as this paper argues, the path that led to the current round of Eurasian integration was not that straight and clear, and the decision to pursue the CU and SES option and its complexities can be better understood if placed in their political and geopolitical context.

The paper starts with a brief overview of possible/impossible alternative economic integration options open to or explored by the Kazakhstani government. To address the issue of why Kazakhstan has privileged the Eurasian vector of integration over the others, it assesses the relative importance of economics, politics and geopolitics for decision-making on trade issues under President Nursultan Nazarbayev. The official discourse is analyzed along with other discourses provided by the expert community and business representatives. Finally, the paper looks at the first economic and political results of the CU; discusses the prospects of Eurasian integration from the point of view of sustainability and utility taking into account Russia's WTO accession and the upcoming one of Kazakhstan; and attempts an analysis of its implications for Kazakhstan's foreign policy.

Possible/Impossible Economic Integration Alternatives

Since early independence Kazakhstan has pursued a policy of economic liberalization and integration with global markets. It was quickly clear that autarky was not an option (according to one calculation, in isolation Kazakhstan could produce only 28.1% of its final product).¹ Therefore, the leadership of the country considered integration as an unavoidable necessity, part of a contemporary trend (globalization), and focused on attracting investments and developing foreign trade options.² While this general goal was clear and uncontested, the ways and strategies for achieving it were less obvious.

Eurasian integration

The first choice was (re-)integration with Russia, together with the rest of the post-Soviet space. Kazakhstani leadership tried to stop “the dangerous process of the chaotic disintegration” pregnant with inter-ethnic and inter-religious conflicts. The country’s ethnic composition (40% Kazakhs, 38% Russians, 22% other minorities) at the time of independence made a scenario of violent fragmentation potentially disastrous.

The economic factor played an important role as well. In 1991, 92.2% of Kazakhstani export was going to CIS countries, predominantly to Russia, and the country’s industries were still tightly linked into the Soviet production cycles. In 1992-93 the Kazakhstani government made major efforts to remain inside the ruble zone. In October 1993, Kazakhstan, together with five other post-Soviet republics, signed the Agreement on the creation of the new ruble zone.³ Nevertheless, Moscow “squeezed out” Kazakhstan and the

¹ S. Primbetov, *Tsentrlnaya Azia. Realii I perspektivy ekonomicheskoi integratsii* [Central Asia. Realities and Prospects of Economic Integration], Moscow, 2000, p. 62.

² N. Nazarbayev, “Vmeste my mozhem soprotivlyatsya globalizatsii” [Together, We Can Withstand Globalization], *Nezavisimaya gazeta*, 29 April 2001.

³ The “Agreement on practical measures for the creation of the ruble zone of the new type” was signed by heads of governments of Armenia, Belarus, Kazakhstan,

signatories, having decided that the burden of keeping them was too heavy.⁴

In March 1994, President Nursultan Nazarbayev made another attempt to stop disintegration and proposed the creation of a Eurasian Union during a meeting with the faculty and students of Moscow State University. At the time Moscow was not ready for this bold initiative, but it was reviewing its policies of “going West” and ‘shedding the burden” of Central Asia. In August 1994 Russian Foreign Minister Andrey Kozyrev stated that Moscow was ready “to go as far as and in the integration forms for which our partners (CIS states) are ready.”⁵

In 1995-6, Russia, Belarus, Kazakhstan and Kyrgyzstan formed a Customs Union (CU-95), which existed largely on paper.⁶ The failure of the project became particularly obvious when Kyrgyzstan joined the WTO in 1998 without consulting with the other CU-95 member-states. To their displeasure, about 60% of tariff lines accepted by Kyrgyzstan as a result of WTO negotiations were considerably lower than those agreed in the framework of the union.⁷

In 2000 Vladimir Putin initiated the transformation of the CU-95 into a more realistic and functional organization—the Eurasian Economic Community (EurAsEC). The goal of the project was to help member-states form a customs union and advance a free trade zone regime. In October 2007 Russia, Belarus and Kazakhstan signed the Treaty on the creation of the Customs Union and in January 2010, the CU was officially launched.

The bilateral trade statistics, however, show that despite the consistent efforts to integrate that took place since mid-1990s, Russia’s share in Kazakhstan’s foreign trade by the time the CU was created had decreased considerably. In 1995 Russia accounted for 47% of Kazakhstan’s total trade turnover; by 2000, its share had declined to 30.2%, and in 2009—17.4%.⁸

Kyrgyzstan, Russia, Tajikistan and Uzbekistan in September 1993.

⁴ Interview with G. Marchenko, Chair of the National Bank of Kazakhstan, *Kontinent*, No 20 (107), 22 October-4 November, 2003.

⁵ As quoted in S. Gretskey, “Russia’s Policy Toward Central Asia,” Carnegie Endowment for International Peace, Carnegie Moscow Center, 1997.

⁶ Tajikistan joined the CU-95 in 1999.

⁷ S. Primbetov, *op. cit* [1], p. 363.

⁸ In 1995 Kazakhstan-Russia trade turnover was \$4.2 billion, in 2000—\$4.1 billion, and in 2009—\$12.4 billion. Source: Statistical Agency of the Republic of Kazakhstan, *Kazakhstan za gody nezavisimosti 1991-2010* [Kazakhstan during the Years of Independence 1991-2010], Astana 2011.

Central Asian integration

The second option was to focus on Central Asian integration. Post-Soviet Kazakhstan and four former “Middle Asian” republics (Kyrgyzstan, Uzbekistan, Tajikistan and Turkmenistan) adopted a new “Central Asian” identity. The common sense of vulnerability and high level of interdependence in terms of water management, gas distribution networks and electricity grids were significant drivers of regional cooperation and integration efforts.

In the early 1990s, failing to interest Russia in integration projects, Kazakhstani leadership spearheaded the initiative to create the Central Asian Union. In 1994, Kazakhstan, Uzbekistan, and Kyrgyzstan signed an agreement on the creation of a Single Economic Space. Commitments were made to push for free movement of goods, services, capital and labor, along with coordination of budget, taxation, pricing, customs and currency policies. In order to make the organization operational, member states set up an Interstate Council as the highest body, and an Executive Committee with responsibilities for coordination, consultation and analysis.

In 1998, Tajikistan joined. The same year, the organization changed its name from Central Asian Union to Central Asian Economic Union (CAEU). However, these efforts could not stop further fragmentation of the region: the volume of intraregional trade peaked at \$841.5 million in 1996, but starting with 1997 it began to fall.⁹ In 2006 the CAEU officially disappeared through merger with EurAsEC.

In 2007 Nazarbayev again proposed the creation of the Central Asian Union. The idea was reiterated in his article “Eurasian Union: from Idea to the Story of the Future” published on 27 October 2011 in Russian newspaper *Izvestiya*. Nazarbayev outlined his vision of the emerging Eurasian Union, but also argued that it did not prevent the creation of other structures, such as the Central Asian Union.¹⁰

With hind knowledge, the failure of Central Asian integration seems inevitable. Although it did make sense to stick together to withstand external pressures, this rationale/factor proved weaker than the structural constraints: different levels and paths of economic development and overall weakness of economic and political systems.¹¹ Importantly, the main economic interests of Central Asian

⁹ S. Primbetov, *Tsentralnaya Azia...*, *op. cit* [1], p. 206.

¹⁰ N. Nazarbayev, “Evrasiyskiy soyuz: ot idei k istorii budushego” [Eurasian Union: from Idea to the Story of the Future], *Izvestiya*, 27 October 2011, <<http://izvestia.ru/news/504908>>.

¹¹ More on constraints of Central Asian integration in A. Bohr, “Regionalism in Central

states increasingly lay outside the region. In 1999, only 3.1% of Kazakhstan's trade turnover was with members of the CAEU, and in 2009—2.7% (\$1.95 billion).¹²

Integration with global markets: WTO membership and free trade zone with China

The third option available in the 1990s was to focus on integration with markets outside the post-Soviet space. Joining the WTO was deemed the main tool for pursuing this goal. In 1996 Kazakhstan submitted the official application to the Secretariat of the WTO. A working group with the participation of Kazakhstan's key trading partners (EU, US, China, Canada, Japan, Australia, Switzerland, South Korea, and others) was created, and negotiations started.

High rates of economic growth and increasing foreign trade in the early 2000s stimulated the desire of the Kazakhstani government to join the WTO. In March 2006, President Nazarbayev devoted his annual address to the people of the country to the new strategy of making Kazakhstan one of the top fifty most competitive economies, in which he prioritized WTO accession as “an additional tool of economic modernization and strengthening competitiveness of Kazakhstan in the world markets.”¹³ In February 2008, the Deputy Minister of Industry and Trade Zhanar Aitzhanova stated that Kazakhstan was planning to complete negotiations in 2009.¹⁴

Outside the post-Soviet space, of particular importance and promise was trade developing with two economic powerhouses of the Eurasian continent: Europe and China. Both became major markets for Kazakhstani hydrocarbons and metals, and providers of manufactured goods. Starting in 2004, the EU surpassed Russia as Kazakhstan's main trading partner, and in 2009 its share in the latter's total trade turnover reached 40.2% (against Russia's 17.4%). China's trade with Kazakhstan has been growing with geometric

Asia: New Geopolitics, Old Regional Order”, *International Affairs*, No. 80, 3 (2004), p. 482-502.

¹² Statistical Agency of the Republic of Kazakhstan, *op. cit.* [8].

¹³ Address of the President of the Republic of Kazakhstan, Nursultan Nazarbayev, to the People of the Republic of Kazakhstan, 1 March 2006, Web-site of the President of the Republic of Kazakhstan,

<www.akorda.kz/en/page/page_address-of-the-president-of-the-republic-of-kazakhstan-nursultan-nazarbayev-to-the-people-of-kazakhstan-march-1-2006_1343986805>.

¹⁴ “Kazakhstan priostanovil peregovory po vstupleniyu v VTO” [Kazakhstan Suspends WTO Entry Talks], *Vesti.ru*, 12 June 2009, <www.vesti.ru/doc.html?id=292462>.

progression as well. In 1999 it accounted for 5.7% of Kazakhstan's external trade and in 2009—13.2%.¹⁵

The EU fully supported the prospect of Kazakhstan joining the WTO and provided considerable technical assistance to reach this goal. China joined the WTO in 2001, but did not actively push Kazakhstan's accession. Beijing preferred to promote the creation of a free trade zone (FTZ). In 2003, Prime Minister Wen Jiabao at the meeting with his Russian, Kazakh, Kyrgyz, Tajik and Uzbek counterparts proposed to establish a FTZ in the framework of the Shanghai Cooperation Organization (SCO). Wen also proposed improving the flow of goods by reducing non-tariff barriers in customs, quarantine, standards and transport services.¹⁶ The proposal of such regional integration did not receive an enthusiastic response.

Thus, the three options briefly introduced above (integration with Russia, Central Asian Union, and WTO accession) were all indicated as priorities, and therefore, officially, not presented as incompatible. Although these three integration options did not exclude each other, they could not be prioritized and fully pursued simultaneously. Such multiple integration agenda inevitably implied tensions and inconsistencies in the implementation.

¹⁵ Statistical Agency of the Republic of Kazakhstan, *op. cit.* [8].

¹⁶ *China Daily*, 24 September 2003.

Motivation behind the Decision to Join the Customs Union

In Kazakhstan there are no established political spaces for public discussion and contestations of major foreign and domestic policies. The key decision-maker is the President of the country, and the processes of adopting policies remain very opaque. Therefore, we can only speculate about the real motives of the decision to actively pursue the Eurasian integration project on the basis of speeches, articles and interviews of the President and other high officials, as well as expert opinions. The possible reasons can be divided into three categories: economic, political and geopolitical.

Economic reasons

The economic explanation can be described as the mainstream official justification. President Nazarbayev, Prime Minister Karim Massimov, officials from the Ministry of Industry and Trade and Customs Committee stress the benefits of the CU for the economic development of the country first and foremost. President Nazarbayev in an interview to state media in December 2009 listed them as follows. First, the CU creates a market of 170 million people instead of 16 million, which should attract foreign investors. Second, the elimination of customs tariffs in Russia and Belarus improves opportunities for Kazakhstani producers, making their goods more competitive in terms of prices (and it is only there where they can realistically find a market), as well as being beneficial for transporting Kazakhstani oil and gas. Third, tougher competition with Russian and Belarusian goods would stimulate Kazakhstani producers.¹⁷

To support their optimistic views on the CU, officials point out Kazakhstan's comparative advantage over Russia and Belarus in terms of attractiveness for investors. It has a lighter taxation regime (12% Value Added Tax, 1% Property Tax, 11% Social contributions against Russia's 18%, 2% and 26% accordingly) and relative ease of doing business (Kazakhstan ranking 59th against Russia at 123rd in

¹⁷ Nazarbayev's interview to state media, 23 December 2009, <www.zakon.kz/157824-nursultan-nazarbaev-schitaet-sozdanie.html>.

2011).¹⁸ It is hoped that these conditions would also lure Russian companies to register in Kazakhstan.

As for exposing Kazakhstani businesses to competition with Russian and Belarusian producers, it is supposed to prepare them for more fierce competition in the framework of the WTO.¹⁹ The CU was presented as some sort of a training camp for global trade.

The optimistic expectations of Kazakhstani officials, however, were not supported by publicly available studies of the potential gains and losses of joining the CU. Development of such studies would have been difficult, if not impossible, considering the speed of decision-making and implementation of the integration project and also the fact that the option of WTO accession was being pursued at the same time.

The most solid studies on these two options of trade integration were carried by experts from the World Bank (WB). According to the report “The Impact of Kazakhstan Accession to the World Trade Organization: A Quantitative Assessment,” Kazakhstan would gain about 6.7% of the value of its consumption (or 3.7% GDP) in the medium run and up to 17.5% in the long run. The largest gains would come from liberalization of barriers to foreign direct investment (FDI) in the services sectors, a reform of tariffs, improved market access and reform of local content regulation.²⁰

WB experts were more skeptical about Kazakhstan’s gains from its participation in the CU. In the report “Assessment of Costs and Benefits of the Customs Union for Kazakhstan” published in January 2012, they developed three possible scenarios: Customs Union current, pessimistic outlook and optimistic outlook.²¹

The first scenario assumes that the external tariffs, with exceptions, are raised to the levels that prevailed in the spring of 2011. It is estimated that in this case Kazakhstan would lose about 0.2% in real income per year as a result of participation in the CU. It is also estimated that collected tariff revenues in Kazakhstan approximately double, that the costs to businesses and consumers of imports increase, and that under the tariff umbrella resources are

¹⁸ The World Bank and the International Finance Corporation *Doing Business in 2011. Making a Difference for Entrepreneurs*, <www.doingbusiness.org/~media/fpdkm/doing%20business/documents/annual-reports/english/db11-fullreport.pdf>.

¹⁹ On-line interview with Deputy Minister of Economic Development and Trade T. Suleimenov, 30 March 2010, <www.bnews.kz/ru/conferences/view/27/>.

²⁰ J. Jensen and D. Tarr, *The Impact of Kazakhstan Accession to the World Trade Organization: A Quantitative Assessment*, World Bank Policy Research Working Paper, WPS 4142, March 2007.

²¹ World Bank Poverty Reduction and Economic Management Unit. Europe and Central Asia Region, *Assessment of Costs and Benefits of the Customs Union for Kazakhstan*, Report No. 65977-KZ, 3 January 2012.

shifted to areas of inefficient production. Consequently, the CU would depress real wages by 0.5% and the real return on capital by 0.6%. Kazakhstan would trade less with the rest of the world and more with Russia, Belarus, and the rest of the CIS, resulting in less imported technology from the more technologically advanced European Union and other countries—leading to a loss of productivity gains in the long run.

The pessimistic outlook scenario assumes that the common external tariffs are fully implemented and exceptions are eliminated. In this case, Kazakhstan would lose about 0.3% in real income per year.

Finally, the third outlook scenario makes an optimistic assessment of how much the CU may lower the trade-facilitation costs in importing to or exporting from Kazakhstan and how much Kazakhstan may benefit from a reduction of non-tariff barriers, such as sanitary and phyto-sanitary conditions, in the CU. It is assumed that the common external tariff is fully implemented. In this case the real income of Kazakhstan would increase by about 1.5% of consumption per year.

Thus, the project of joining WTO in the pre-CU conditions would be more economically reasonable than the formation of the CU, which implies that the motivation to privilege the Eurasian integration over WTO accession is to be found elsewhere.

Political reasons

The political explanation behind the decision to form the CU focuses on regime security and group interests. This is the most difficult one to reconstruct.

One line of thinking points to the growing concerns with regard to the security and stability of the country. The ongoing global economic crisis affected Kazakhstan and endangered the prospects of its development. Worsening of the economy would fuel protest sentiments and can undermine the stability of the country. As President Nazarbayev argued in his article published in the Russian newspaper *Izvestiya* in March 2009, the crisis destroyed the illusions (of self sufficiency) fueled by high prices on natural resources, and now to survive and prosper countries would need to pull their efforts together.²²

Another factor creating potential for instability is the lack of clarity with political succession. In 2009 President Nazarbayev

²² N. Nazarbayev, "Evraziyskiy ekonomicheskiy soyuz: teoriya ili realnost" [Eurasian Economic Union: Theory or Reality], *Izvestiya*, 19 March 2009.

turned 69, and there is no apparent groomed “heir” to the position in order to make the post-Nazarbayev transition smoother.

External factors, such as growing instability potential in Central Asia and Afghanistan, and fears of “color revolutions” also contributed to the sense of insecurity in Kazakhstan. All these factors could have made the Kazakhstani leadership lean more toward Russia, the traditional patron who can provide the regime with certain security guarantees.

Another line of thinking tries to answer the question “cui prodest?” and find out if any powerful business group would particularly benefit from the CU arrangements. Here the prime suspects are the oil and gas producers who can potentially get better and cheaper access to pipelines crossing Russia and Belarus. In December 2010, the CU members agreed to introduce unified norms and standards on oil and oil products and equal tariffs on transportation of oil and oil products in the framework of SES.²³

An interesting development took place in June 2011, Timur Kulibayev, head of the Kazenergy association of oil and gas companies, chairman of the Samruk-Kazyna Welfare Management Fund, and son-in-law of President Nazarbayev, joined the board of directors of Russia’s Gazprom.²⁴ Moscow’s decision to invite Kulibayev to its key company seemed to signal the possibility of important mergers between the two national energy sectors.²⁵

Geopolitical reasons

The geopolitical explanation behind the decision underlines the necessity of making a choice among great powers and defining what “civilization” Kazakhstan belongs to. This implies that the period of uncertainty and balancing reflected in Kazakhstan’s multi-vector foreign policy is no longer sustainable. This position was expressed by Bahytzhamal Bekturganova, President of the Institute of Political Solutions, at the roundtable devoted to the CU: “The Customs Union is first of all, an instrument of regional integration, and in this sense, national protection instrument. We need this integration to protect our national sovereignty. This will be our new civilizational identity.”²⁶

²³ *Expert Kazakhstan*, 13 December 2010, <<http://expert.ru/kazakhstan/2010/49/diversifikatsiya-neftedvizhenij/>>.

²⁴ In December 2011, after months of strike action in the oil town of Zhanaozen, the situation turned violent, however; Kulibayev was removed from the position of the head of Samruk-Kazyna Fund.

²⁵ Weekly newspaper *Respublika* reported rumors on the upcoming sale of shares of Kazakhstani national oil and gas company Kazmunaigaz to Russian Gazprom, 23 September 2011.

²⁶ Roundtable “Kazakhstan v tamozhennom soyuze: chto delat dalshe?” [Kazakhstan

Although officials try not to stress the geopolitical meaning of the CU, at the same roundtable Kuandyk Bishimbayev, Deputy Minister of Economic Development and Trade of Kazakhstan stated: “The Customs Union should be considered in the context of geopolitical processes. [...] What economic gravity pole we will be drawn to? And choosing the CU, we clearly choose the economic gravity pole.”²⁷

The “moment of truth” had been brought closer by the global economic crisis. In the March 2009 article, Nazarbayev argued that the crisis made clear the necessity of pulling efforts together, and “in the long term there is no alternative to Eurasian integration.”²⁸

Possible/impossible alternatives to Eurasian integration (Central Asian integration, joining WTO and free trade zone with China) were briefly discussed in the previous part of the paper. Since Central Asian integration in economic terms is not of major interest for Kazakhstan, only two other options should be considered from the geopolitical point of view: joining the WTO as promoted by the West (both the EU and US), and economic integration with China.

The Western vector has been always a strong competitor to the Russian one due to the appeal of the West as the source of investments, technologies, legitimacy, and security assistance. The only two factors that constrained Kazakhstani leadership’s desire to deepen relations with Washington and European capitals have been the concern not to anger Moscow and the fear of Western democratization agendas.

This tension between pro-Russian and pro-Western directions of Kazakhstan’s foreign policy surfaced when Kazakhstani government had to make the decision to join WTO or CU first. According to Wikileaks cables, in February 2009, Prime Minister Karim Massimov met with US Ambassador Richard Hoagland and told that he needed a clear signal from Washington that Kazakhstan is welcome in the WTO. Upon receiving such a signal, he promised to stall the process of the CU formation.²⁹ This means that Kazakhstan needed stronger support from the West to gather determination to pursue WTO membership without Russia.

Integration with China as an alternative option was never pursued by the Kazakhstani government, as discussed earlier. The fears that the country will be overwhelmed by Chinese economic, demographic and eventually political power are clearly present in the Kazakhstani society. Some experts expressed an opinion that the CU and further integration with Russia are to constrain growing Chinese

in the Customs Union: What Should be the Next Steps?], organized by the Institute of Political Solutions, 19 April 2011, <www.ipr.kz/print/kipr/3/1/27/ajax>.

²⁷ *Ibid.*

²⁸ N. Nazarbayev, *op. cit.* [22].

²⁹ *Respublika*, 09 September 2011.

influence in Central Asia.³⁰ Interestingly, President Nazarbayev decided to refute it in his 2011 *Izvestiya* article. According to him, “some Western experts rushed to state that the Eurasian Union is to become a defense from the so called Chinese economic expansion. There is nothing more remote from truth than this statement.”³¹

Kazakhstani policy toward China seems to be complex. On the one hand, Astana continues to deepen relations with Beijing despite growing fears of Chinese might. Over the last several of years they grew stronger with the acquisition of prime energy assets by Chinese companies (accounting for 26% of investments in the oil and gas sector and 20% of oil produced in the country) and massive loans (estimates range between \$15 and \$19 billion) taken from China by Kazakhstani government and companies.³²

On the other hand, Astana continues to reject Beijing’s proposals for FTZs. As mentioned earlier, in 2003 Prime Minister Wen Jiabao suggested establishing an FTZ in the framework of the SCO. In June 2011, President Hu Jintao visited Kazakhstan and made a six-point proposal to boost bilateral cooperation. He suggested: establishing a FTZ; protecting mutual investments by pushing forward currency swaps and trade settlements in local currencies; more cooperation in the energy sector; developing non-resource based industries, making them hi-tech, energy efficient and environmentally friendly; improvement of transportation routes; and finally collaboration in agricultural sectors.³³

While not ready for a full-fledged FTZ with China, the Kazakhstani government agreed to build a free economic zone (FEZ) on the border. In 2006 the two countries began constructing Khorgos FEZ that is to become fully operational in 2018.³⁴ The plan is to have an international business center, a trade zone, freight terminals, an airport, a tourism center, sports facilities, seven five-star hotels, and cultural zone with exhibition centers, art galleries and an ethnographic park. It is expected that the venture will give a boost both to bilateral trade and to trade between China and Europe.³⁵

³⁰ *Liter*, 18 March 2011.

³¹ N. Nazarbayev, *op. cit.* [10].

³² N. Nazarbayev’s speech at the presentation of the Astana-Almaty high speed railway project in Beijing, 22 March 2011, <http://temirzholy.kz/kz/press_center/news/page_795>; *Exclusive*, 8 October 2012, <<http://exclusive.kz/articles/portret/12835>>.

³³ China Radio International, 14 June 2011, <<http://english.cri.cn/6909/2011/06/14/2741s642736.htm>>.

³⁴ In April 2012, the Khorgos FEZ opened for human traffic, tourists and investors, <www.mcps-khorgos.kz/smi-review/prezentatsiya-dlya-investorov-i-smi-transportno-logisticheskogo-khaba-«khorgos»-stantsiya>.

³⁵ J. Lillis, “Kazakhstan: Astana Sees Free-Trade Zone as Antidote to Dutch Disease,” *Eurasia.Net.org*, 31 May 2010, <www.eurasianet.org/print/63587>.

Thus, Kazakhstan wants to benefit from opportunities that cooperation with China presents, but it is hesitant to find itself in the full embrace of its eastern neighbor. From this perspective, Eurasian integration can serve as a useful counterbalance.

Eurasian Economic Integration: Results and Implications

After almost three years of existence, we can now draw preliminary conclusions about the CU's results and check them against the initial expectations summarized in the previous section. The range of opinions regarding the gains, losses and implications of Kazakhstan's participation in the project remains broad and polarized.

The analysis is made more difficult by a series of significant developments that took place since the start of the CU in 2010. In January 2012, Russia, Kazakhstan and Belarus launched the SES to promote the freedom of movement of capital, people, and services and promised to create the Eurasian (Economic) Union by 2015. In the meantime, in December 2011 Russia joined the WTO; Kazakhstan is finalizing its negotiations and expects to join the organization in 2013. This very complex dynamic creates confusion, but at the same time it sheds lights on the nature of planning and decision-making of participating governments.

Economic results and prospects

Government officials continue to enthuse about the Customs Union and its benefits. To prove that it lived up to high expectations, they provide numbers showing increases in trade turnover and Kazakhstan's exports. In 2010, the turnover between Russia and Kazakhstan increased from \$12.4 billion to \$17.9 billion, between Kazakhstan and Belarus—from \$421 million to \$865 million. The reported numbers for 2011 are even more impressive. Kazakhstan's trade with Russia reached \$22.7 billion (while with Belarus it decreased to \$698 million).³⁶

What accounts for such hikes in numbers? Firstly, the increase is less considerable if compared with the pre-crisis 2007 and 2008 figures—Russia-Kazakhstan trade turnover stood at \$16.2 billion and \$20 billion accordingly.³⁷ Secondly, as admitted by the

³⁶ Statistical Agency of the Republic of Kazakhstan, *op. cit.* [8].

³⁷ *Idem.*

Kazakhstani Minister for Economic Integration Zhanar Aitzhanova, increase in foreign trade turnover was due to higher prices on main export items: oil (38.8% increase), ferrous-alloys (24%), and steel (31.8%).³⁸ In 2010 mineral products accounted for 75% of Kazakhstan's total export, and metals and metals goods for 13.5%.³⁹

It is also worth noting that Kazakhstan has a considerable deficit in its trade with the CU partners. In 2011 Kazakhstan exported \$7.5 billion to Russia and Belarus and imported \$15.9 billion.⁴⁰ The structure of the trade is not in Kazakhstan's favor either: it was exporting mostly minerals and importing manufactured goods.⁴¹

The share of export to Russia and Belarus grew insignificantly in 2010 - from 8.3% of total export in 2009 to 10.1%, and decreased to 8.5% in 2011. At the same time, Russia could increase its share of import to Kazakhstan from 31.3% in 2009 to 39.4% in 2010, and 41.4% in 2011, while the share of the European imports fell from 29% in 2009 to 24.3% in 2010, and 20.4%.⁴² Thus, we can conclude that Russia's position has strengthened, in part thanks to trade diversion.

This trend is due to considerable increases in tariffs. To a large extent, common external tariffs were approximated to Russian ones. According to Deputy Minister of Economic Development and Trade Timur Suleimenov, 47.7% of tariffs were brought in line with Russia, 45% left at the Kazakhstani level of 2009, and for 5% were decreased (for the remaining 2.3% the classification of tariffs changed).⁴³

According to the study conducted by Almaty-based research center Rakurs, after accession to the CU, for the entire economy, the simple mean Ad valorem equivalent (AVE) tariff rate has increased from 6.45% to 12.10%, and the weighted mean AVE tariff rate, from 4.30% to 12.67%. If Kazakhstan had a liberal trade regime before the CU was established, now its level of tariff protection became higher than in the low and middle-income countries, and above the world average. Its average level of tariff protection is the highest among the group of upper middle-income countries, which includes Kazakhstan.⁴⁴

³⁸ Website of the Ministry of Economic Development and Trade, 16 May 2011, <www.minplan.kz/pressservice/482/37253/>.

³⁹ Statistical Agency of the Republic of Kazakhstan, *Kazakhstan in 2010*, Astana, 2011.

⁴⁰ Statistical Agency of the Republic of Kazakhstan, *Kazakhstan in 2011*, Astana, 2012.

⁴¹ "Vzryvnaya poroda. Dolya syrya v torgovle mezhdru RK i RF vyrosla v neskolko raz" [Explosive Rocks. The Share of Raw Materials Has Dramatically Increased in Trade between Kazakhstan and Russia], *Forbes Kazakhstan*, No. 2, February 2012;

⁴² Statistical Agency of the Republic of Kazakhstan, *Kazakhstan 2011*, Astana, 2012; A. Urmanov, "Torgovlya na vynos" [Takeaway Trade], *Karavan*, 7 May 2012.

⁴³ On-line interview with T. Suleimenov, *op. cit.* [19].

⁴⁴ O. Jandosov and L. Sabyrova, *Tariff Protection in Kazakhstan: Before and After*

As a result, Kazakhstani producers using imported Western equipment and materials were severely affected. Tariffs on equipment increased by 10-20%, and those for materials (previously imported with zero-tariff) were raised by 20%.⁴⁵ Thus, high technology products assembled in Kazakhstan went up in price and became non-competitive. Ironically, Kazakhstani producers, who were previously worried about the negative effects of the WTO, are now waiting for it as a salvation, since it would bring back liberalization of trade.⁴⁶

Some representatives of small and medium enterprises describe the situation as a disaster.⁴⁷ Instead of promised simplification, the documentation became bulkier and more confusing. The new unified electronic customs database was prepared in a hurry and is full of deficiencies. Overall, the new customs regulations are seen as cancelling the achievements of the past decade and throwing Kazakhstan back toward the early 2000s on some issues and even 1990s on others.⁴⁸

According to business people, higher tariffs protect Russian producers at the expense of local ones. While Russian goods have full access to Kazakhstan, Russian authorities at the local level have been using double standards to block Kazakhstani goods with the help of various non-tariff barriers. Generally, there is a fear that Russian companies will dominate the Kazakhstani market and reshape it to their liking.⁴⁹ There is a widely shared opinion that Russian companies are using aggressive marketing tactics, actively resort to political and administrative resources, possess much larger capital, and use anti-competitive methods.⁵⁰ According to one leader of the business community, with the CU the Kazakhstani economy was fully surrendered and handed over to Russia.⁵¹

the Customs Union, Discussion Papers 4&5, 2011, <www.cear.kz/index.cfm?uid=F242433D-C29E-8867-1A7E60F32BC32042&docid=24>.

⁴⁵ G. Shestakov, "Rify tamozhennogo soyuza" [Pitfalls of the Customs Union], *Kazakhstan. The International Business Magazine*, Vol. 4, 2011 <www.investkz.com/journals/79/882.html>.

⁴⁶ G. Shestakov, "Vstupleniye v VTO mozhet stat spaseniyem dlya Kazakhstana" [WTO Entry Can be Kazakhstan's Salvation], *Kursiv*, No. 18 (342), 13 May 2010, <www.kursiv.kz/deistvujushie-lica/deistvujushie-lica-weekly/1195203631-vstuplenie-v-vto-mozhet-stat-spaseniem-dlya-kazaxstana.html>.

⁴⁷ Interview with the Executive Director of the Forum of Entrepreneurs of Kazakhstan, 11 October 2011.

⁴⁸ G. Shestakov, *op. cit.* [45].

⁴⁹ *Nezavisimaya gazeta*, 14 September 2011; Remarks made by business representatives at the AmCham Economic Policy Forum "The Customs Union and WTO Accession: Regional and Global Aspirations. Focus on Russia and Kazakhstan," 15 October 2012, Almaty.

⁵⁰ "Tamozhennyi soyuz Kazakhstana: slovo praktikam" [Kazakhstan in the Customs Union: Practitioners Speak], *Exclusive*, 1 March 2010, <<http://exclusive.kz/articles/blc/14>>.

⁵¹ Author's interview, Almaty, 9 September 2011.

The only sector that benefited from new protective barriers is the budding automobile production industry. Tariffs on cars increased 30-40 times, making import from third countries prohibitive. In the first half of 2011, car sales went up 160%: Russian cars accounted for 40.3%, locally assembled—31.7%, and imported from third countries 23%. The improved market reportedly stimulated the interest of investors.⁵²

As for the oil and gas sector, the expected benefits have been slow to materialize. The 2010 agreement on unified norms and standards on oil and oil products and equal tariffs on transportation of oil and oil products in the framework of SES does not regulate tariffs on oil exported outside the SES. Thus, Russian transit tariffs for Kazakhstani exporters remain double those paid by domestic oil companies. Kazakhstani gas exporters do not have equal access to Russian gas infrastructure and have to sell gas at the border.⁵³

Another great hope and promise of the CU was the inflow of foreign companies attracted by a bigger market, Kazakhstan's more liberal taxation regime and better business environment. The country was supposed to become the "springboard for MNCs to enter Russia." Some experts remain skeptical about the potential, arguing that it is unlikely that companies would like to set up production so far from main markets in the European part of the CU.⁵⁴

So far what is happening is the relocation of Russian and Belarusian companies to Kazakhstan. As of January 2012, there are 8,600 Russian and Belarusian companies registered in Kazakhstan accounting for 55.4% of all foreign companies. This is a 16.8% increase compared to the previous year (against 6.5% increase for all foreign companies).⁵⁵

The government is also very proud that the CU brought considerable budget revenues. According to Deputy Minister of Finance Ruslan Dalenov, in 2010 Kazakhstan could receive more than \$1.2 billion, while previously it was getting \$600 million a year in customs duties.⁵⁶ Astana was able to negotiate receiving a 7.33%

⁵² *Forbes* (Kazakhstan), No. 1, September 2011.

⁵³ G. Rakhmatulina, "Vliyaniye tamozhennogo soyuza na ekonomicheskoe razvitiye Kazakhstana. Perspektivy integratsii v neftegazovom sektore" [The Influence of the Customs Union on Kazakhstan's Economic Development. Prospects of Integration in the Oil and Gas Sectors], *Evraziyskaya ekonomicheskaya integratsiya*, No. 1 (14), February 2012, p. 77-92.

⁵⁴ "Soyuzniki ili souzniki? Tamozhennyi soyuz: poltora goda spustia" [Allies or Cellmates? The Customs Union: 18 Months on], *Exclusive*, 14 September 2011, <<http://exclusive.kz/articles/expertise/6333>>.

⁵⁵ "Alikhan Smailov: za pyat let prodovolstviye podorazhalo na 73%" [Alikhan Smailov: In 5 Years, Food Became 73 % More Expensive], *Kursiv*, 15 March 2012.

⁵⁶ Roundtable "Kazakhstan v tamozhennom soyuze", *op. cit.* [26],

share of the total CU import tax (its share in 2007-2008 was less than 3.5% of the aggregate collected by the three states).⁵⁷

The number does look impressive. However, experts point out that this increase took place at the expense of consumers. Prices on goods from non-CU member countries, food and electronic appliances, went up. Russian goods did not become cheaper, partially due to a stronger ruble. As a result, prices on meat, dairy products and vegetable oil almost doubled.

Finally, the argument that the CU will serve as a training camp for joining the WTO becomes less relevant in view of the Russian membership in the organization, and Kazakhstan's accession expected by 2013.⁵⁸ It is still not clear what conditions have been negotiated by the Kazakhstani side, but considering the agreement existing among CU member states that CU member states will adopt tariffs agreed by the member that joined WTO first, it seems likely that the AVE tariff will be the same or close to that currently agreed by Russia—7.15% (in 2009 Kazakhstan's AVE tariff was 5.9%).⁵⁹

The business community is also concerned that the WTO accession once again would introduce confusion in the regulations, similar to the one created by the CU. It does not help that the results of negotiations on accession conditions are not public and Kazakhstani entrepreneurs do not know what to expect and prepare for.⁶⁰

Political impact

If security of the regime was a motivation behind the decision to advance integration with Russia, so far the effect has been mostly negative. Firstly, the creation of the CU pushed up the prices on basic goods creating the potential for social tensions. Secondly, it impacted millions of "self-employed" people engaged in small trade with third countries, particularly China, and consequently their families. Thirdly, it gave nationalists another issue around which they can mobilize popular support and criticize the government.

Over the three-year period (2009-2011) food prices in Kazakhstan increased on average 23.7%: meat and meat products—1.5 times, sugar and nonalcoholic drinks—1.4 times. Over the last

⁵⁷ Interview with T. Suleimenov, *op. cit.* [19].

⁵⁸ RIA Novosti, "Kazakhstan Aims to Conclude WTO Talks by 2013," 27 January 2012, <<http://en.rian.ru/business/20120127/170980037.html>>.

⁵⁹ *Vlast*, 28 March 2012, <www.vlast.kz/?art=149Vlast>.

⁶⁰ Remarks made by business representatives at the AmCham Economic Policy Forum, *op. cit.* [49].

five years food prices grew 73.5%: oil and butter—two times, bread, milk and dairy products, fruit and vegetables—more than 1.5 times.⁶¹

The CU is not the only cause of these price hikes, however, it clearly made a contribution. One of the reasons behind this inflation was the increase in prices on fuel (28-29% growth for gas and 34% for diesel) that was due to opening of the customs borders between Russia, Kazakhstan and Belarus. Kazakhstani prices on fuel that used to be the lowest among the CU member states started leveling with those in Russia.⁶²

The government understood the destabilizing potential of this trend and created a Price Commission under the First Deputy Prime Minister Umirzak Shukeyev.⁶³ In July 2011, the President also signed a law on state regulation of production and circulation of certain types of oil products⁶⁴ that capped retail prices on fuel.⁶⁴ This non-market regulation of prices is reminiscent of the problematic 1990s and cannot be considered a sustainable solution.

The outbreak of violence in the oil producing region of Western Kazakhstan in December 2011 (Zhanaozen events) serves as alarming evidence of this. Oil workers dissatisfied with their salaries that they saw as inadequate to the growing prices on basic goods went on strike in May 2011.⁶⁵ The failure to negotiate an agreement with the workers resulted in bloodshed and growing anxiety among public and political elites.

Another problem created by the CU is the loss of income incurred by small traders and their dependents from the raised tariffs on imports from third countries. It was estimated that an army of 2.5 million of so-called self-employed people were engaged in small trade, and consequently their families.⁶⁶ The loss of income led to personal tragedies and fueled discontent. Ironically, the problem is partially alleviated by the corruption of the Kazakhstani customs service. According to Russian importers, the quantity and quality of Chinese counterfeit products reaching the Russian market via Kazakhstan has increased dramatically as a result of the CU.⁶⁷

⁶¹ "Alikhan Smailov: za pyat let prodovolstviye podorazhalo na 73%," *op. cit.* [55].

⁶² G. Rakhmatulina, *op. cit.* [53].

⁶³ *Novaya Gazeta*, 14 January 2011.

⁶⁴ G. Rakhmatulina, *op. cit.* [53].

⁶⁵ S. Akimbekov, "Kazakhstan posle Zhanaozenya i vyborov" [Kazakhstan after Zhanaozen and Elections], *Tsentralnaya Azia*, 12 March 2012, <<http://asiakz.com/node/117>>.

⁶⁶ "Soyuzniki ili souzniki?" *op. cit.* [54].

⁶⁷ Presentation of D. Fedorkov, Brand Production Director, Baiersdorf (Russia) at the AmCham Economic Policy Forum "The Customs Union and WTO Accession: Regional and Global Aspirations. Focus on Russia and Kazakhstan", 15 October 2012, Almaty.

Finally, while a considerable proportion of the Kazakhstani population welcome the union with Russia, certain vocal groups believe that the CU and forthcoming SES undermine Kazakhstan's sovereignty. On 8 June 2010, on the eve of the launch of the CU, the movement "In Defense of Sovereignty," unifying 50 organizations, democratic opposition parties, youth organizations, media and intelligentsia representatives, published a letter addressed to the people of Kazakhstan. The main message was that Kazakhstan's accession to the CU and SES represents the loss of political sovereignty. The authors argue that in the CU Kazakhstan delegated its foreign economic policies to a supranational body, and with the introduction of SES, it would have to delegate domestic economic powers too. Astana would need to coordinate with Moscow on its macroeconomic policies, budget deficit parameters, inflation, currency exchange rates, oil and gas pricing scenarios, agricultural subsidies, and technical regulation. With time it is planned to establish a single currency and harmonized tariffs on gas and electricity. All this, in the opinion of the authors, means the revival/resurrection of the union state.⁶⁸

Surprisingly, these anti-integration sentiments eventually found some support among important policy experts firmly implanted in the Nazarbayev regime. Thus, Secretary of the ruling Nur Otan part Erlan Karin gave a strong response to the proposal of the creation of the Eurasian Parliament made by Russian Duma Speaker Sergei Naryshkin, denouncing it as "unrealistic in the short and long term" and "in breach with the sovereignty and the Constitution of Kazakhstan".⁶⁹

Such lack of consensus on desirability and extent of Eurasian integration in the society raises the question about how sustainable the project is, especially considering the similar lack of consensus in Russia and Belarus. So far, it was driven by the political will of President Nazarbayev and President/Prime Minister Putin, and it is not clear what will happen when they eventually leave the political scene.

⁶⁸ "Vstupleniye Kazakhstana v tamozhennyi soyuz i edinoe ekonomicheskoe prostranstvo vedet k potere politicheskogo suvereniteta strany!" [Kazakhstan's Entry into the Customs Union and Single Economic Space will Lead to the Loss of Political Sovereignty!], 8 June 2011, <www.zonakz.net/articles/?artid=29733>.

⁶⁹ "Ideya sozdaniya evraziyskogo soyuza dazhe ne obsuzhdaetsya" [The Idea of Eurasian Union's Creation is not Even under Discussion], *Vremya*, 19 September 2012. A similar stance was publicly taken by Presidential Advisor Yermukhamet Yertyspayev, 20 September 2012, <http://tengrinews.kz/kazakhstan_news/ertyisbaev-razgovoryi-o-sozdanii-evraziyskogo-parlamenta-poka-prejdevremennyi-220606/>.

Geopolitical implications

It is too early to assess the geopolitical impact of the CU, however, it is possible to make a preliminary analysis of the effect that it had on Kazakhstan's multi-vector foreign policy and the balancing acts that Astana had been so good at. How strong is the tilt of Kazakhstan toward Russia? How will it affect Kazakhstan's relations with two of its major economic partners—EU and China—who also happen to be two other poles of geopolitical power in the Eurasian continent? And what will be the impact on Kazakhstan's relations with the rest of Central Asia?

The creation of the CU and SES showed that the leadership of Kazakhstan decided to subordinate its trade and economic policies to Russia. However, over the last three years there have been important changes in the decision-making mechanisms indicating that the Kazakhstani leadership had second thoughts with regard to the degree of this subordination. In the first supranational body, the CU Commission, 57% of votes belonged to Russia and 21.5% to Kazakhstan and Belarus each. The decisions were made with two-thirds of the votes, providing for clear dominance of Russia in deciding on international trade issues. In the Eurasian Economic Commission (EEC) that substituted the CU Commission with the launch of the SES in January 2012, there is equal distribution of votes following the model of the European Commission. In the Council of the Commission composed of the heads of state decision-making is by consensus, and in the Collegiate organ of the Commission that includes three representatives from each member state, the decisions are made by qualified majority voting.⁷⁰

At the same time, the unequal weight of the economies of the member states is reflected in the distribution of quotas for staff of the EEC: 84% for Russian citizens, 10% for Kazakhstani citizens, and 6% for Belarusian citizens. Consequently, the financing of the EEC was decided as follows: Russia—87.97%, Kazakhstan—7.33%, and Belarus—4.7%.⁷¹ This gives certain leverage for Russia to shape the SES.

With the launch of the SES in January 2012, Astana might have reached the limit of its integration ambitions. At the March 2012 EurAsEC summit, it blocked Moscow's initiative to reorganize the community into the Eurasian Economic Union, asking not to hurry.⁷²

⁷⁰ Agreement on the creation of the Eurasian Economic Commission, 18 November 2011.

⁷¹ A letter of Minister for Economic Integration Affairs Zh. Aitzhanova, *Vremya*, 27 September 2012.

⁷² "Lukashenko: transformatsiyu EvrAzES pritorozil Kazakhstan" [Lukashenko: Kazakhstan Impeded the Transformation of the Eurasian Economic Community],

A lack of noticeable changes in Kazakhstan's multivector foreign policy also seems to indicate that the tilt toward Russia has been smaller than it appeared in 2009-10. On a trip to Turkey in October 2012 Nazarbayev even allowed himself statements critical of Russia's historical role in the region saying that in 150 years of being the colony of the Russian empire and then the Soviet Union, Kazakhs almost lost their traditions, customs, language and religion. He called on Turkic peoples to unite and become an effective force in the world.⁷³

Kazakhstan continues to pursue closer relations with the EU and China. While in political terms there are some constraints—Astana is increasingly intolerant of European democratization and human rights promotion efforts and remains concerned with the implications of the rise of China—the pull-factor of their vast economies remains strong. In fact, the SES can in no way substitute for European and Chinese markets—in 2010 Kazakhstan's exports to Europe stood at \$32 billion (53.2% of all exports) and at \$10.1 billion (16.8%) for China.⁷⁴ Importantly, unlike Europe and China, Russia and Belarus are not major sources of technologies, investments and best practices. In this regard, the CU and SES do not present a challenge to Europe and China. However, their formation, to some extent, re-establishes the traditional role of Russia as “the window to Europe,” and Kazakhstan has once again attached itself to the Russian modernization train.

As for Kazakhstan's relations with the rest of Central Asia, the impact of the CU and SES has been already considerable. To fulfill its membership obligations, Kazakhstan adopted stricter regimes regulating export of goods and strengthened its southern borders. These measures hindered intraregional trade and undermined the economy of Kyrgyzstan dependent on re-export of Chinese goods, in particular. It was reported that in 2010-11 the number of wholesale traders in the country reduced by 70-80%, and the number of retail traders by 30-40%.⁷⁵

Although both Kyrgyzstan and Tajikistan announced their interest in joining the CU and both are encouraged by Russia and Kazakhstan, such an expansion in the near future is unlikely due to massive problems that it would entail. Moscow can continue to entertain broader geopolitical ambitions, but the realities on the ground dictate the more feasible goal of making the relatively prosperous “core” of post-Soviet space integration work.

Newsru.com, 21 March 2012,

www.newsru.com/finance/21mar2012/lukashenko.html.

⁷³ “Idem prezhnim kursom” [We will Follow the Same Course], *Karavan*, 19 October 2012, <www.caravan.kz/article/52786>.

⁷⁴ Statistical Agency of the Republic of Kazakhstan, *Kazakhstan 2011*, Astana 2012.

⁷⁵ “Kyrgyzstan: tamozhennyi soyuz udaril po torgovtsam s rynka Dordoi” [Kyrgyzstan: Customs Union Hit Dordoi Market Vendors], *Ferghana.ru*, 1 November 2011, <www.ferghananews.com/news.php?id=17566>.

In this sense, the formation of the CU and SES can result in the institutionalization of Central Asia's fragmentation. Overall, the region of Central Asia is increasingly becoming a zone of potential instability considering the lack of proper political succession mechanisms, growing economic disparities, nationalism and Islamism. Russia and Kazakhstan do not seem to have a plan for how to address these challenges.

Conclusion

The creation of the CU in 2010 and SES in 2012 constitutes a major breakthrough for Eurasian economic integration project, promoted by Kazakhstani President Nursultan Nazarbayev since the early 1990s. While a union with Russia has been always an official priority, other trade integration alternatives have been pursued by the Kazakhstani government as well. The one that was in strong competition with the CU option was the prospect of joining the WTO and this way advancing Kazakhstan's integration with global markets and making the country's economy more competitive. The tension between these two options remained until 2009, when the decision was made to join the CU first.

Analysis of the possible motives (economic, political and geopolitical) for the Kazakhstani leadership's decision to privilege integration with Russia over joining the WTO shows that economic reasons—emphasized in the official discourse—did not play the main role. Political reasons (primarily, the concern with security) seem to have been more prominent.

The overview of the results of the two years of the CU existence shows that they have been mixed at best, despite the continued enthusiasm of the government officials. The introduction of higher external tariffs hurt Kazakhstani producers (except for exporters of minerals and metals) and consumers, while the opening of the customs borders did not result in major growth of Kazakhstani exports to CU member-states. It remains to be seen on what conditions Kazakhstan will be joining the WTO, and whether this can partially alleviate the negative impact of the CU.

As for the political impact, the Eurasian integration project allowed the mobilization of nationalist forces around the issue and gave them a strong argument in opposing the government. The inflation stimulated by the CU also increased the potential of instability in the country. The sustainability of the project is not assured, since Eurasian integration is promoted largely through the political will of the member-state presidents, and there is lack of public consensus regarding the usefulness of the CU, SES and future Eurasian Economic Union.

In geopolitical terms, the formation of the CU and SES has not affected noticeably the traditional multi-vector foreign policy of Kazakhstan. The lack of internal dynamism and resources of the Eurasian economic integration project means that it does not

constitute a major challenge to Europe and China, two major trade partners of Kazakhstan. However, it does, to some extent, re-establish Russia's traditional role as Kazakhstan's "window to Europe."

The CU created a bigger challenge for Kazakhstan's Central Asian neighbors, particularly, Kyrgyzstan. To fulfill its obligations toward CU partners, Kazakhstan strengthened its southern borders and introduced stricter trade regimes. Unless Kyrgyzstan and Tajikistan are engaged in the integration project, as promised by President Putin and President Nazarbayev, the development of the SES would mean further fragmentation of the Central Asian region. Such integration, however, seems unlikely in the near future due to the serious challenges that it would entail.