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GETTING ALONG

The Case for Regional Economic Integration in the Commonwealth of Independent States

Abstract

From the ruins of the collapsed Soviet empire emerged 15 new independent countries. The communist command economy had integrated the Soviet territory closely in terms of production and transportation networks, which were effectively dissolved in the early 1990s. The newly independent states were left with a set of problems, with which they continue to struggle today. Several attempts have been made at recreating lost linkages by establishing regional trade blocs, but these efforts have in most cases resulted in failure. Political trust, trade, and development remain far below their potential in the CIS. Economists and other social scientists have opposed the formation of regional trade blocs and instead suggested the introduction of multilateralism coupled with market liberalisation – often referred to as the Washington Consensus – as the "first-best" development strategy for the CIS countries. In this thesis, I present an alternative normative view. I argue that multilateralism by itself will fail to neutralise the problems which currently impede the integration of the CIS into the global economy. In particular, the overwhelming transportation costs from Central Asia and Transcaucasia cannot be mitigated without close regional cooperation. Thus, I propose that the CIS countries continue to seek regional integration while at the same time striving for WTO membership. The latter will serve to anchor liberal trade norms in a region currently characterised by authoritarianism and protectionism. The international community, particularly the EU, the USA, and the Bretton Woods institutions, should support the formation of a strong regional trade bloc, which could also serve as a useful forum to settle mutual non-trade issues, including water and energy supply management. As a result, I believe that the geographically and economically isolated southern-tier countries in the CIS will be able to grow increasingly competitive, transparent, and rich.

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Table of Contents

1 Introduction 1
1.1 Delimitations of Scope 3
1.2 Outline 4
2 Background: The History of CIS Integration 4
2.1 The Break-up of the Soviet Administrative Command Economy 4
2.2 Regional Integration Projects after Independence 9
3 Identifying the Obstacles to CIS Integration 11
3.1 Geographic Constraints 14
3.2 Economic Legacies of the Soviet Period 18
3.3 Political Economy 19
3.4 Political and Security Obstacles 19
4 The Theory of Economic Integration 24
4.1 Levels of economic integration 25
4.2 The Theory of Customs Unions 26
4.3 Dynamic Efficiency 29
4.4 Regional versus Multilateral Economic Integration 30
5 Finding a Workable Development Strategy 32
5.1 The Case for Regionalism in the CIS 34
5.2 Conditions for Success 38
6 Conclusions 39
7 Suggestions for Further Research 39
8 Bibliography 41

Appendix 1: Regional Economic Integration Projects I
Appendix 2: Map of the FSU X
Appendix 3: Intra-CIS Trade of CIS Countries XI
Appendix 4: CIS Trade with Russia XII
Appendix 5: CIS Trade Bloc Members XIII
Appendix 6: GDP per Capita in the CIS XIV
Appendix 7: Commodity Concentration of Exports Share of the Three Main Export Products (in Percent) XV

List of Figures

Figure 1. The spaghetti bowl effect of regional and bilateral trade agreements involving the CIS countries (as of August 2005) 13
Figure 2. Oil production in the CIS 22
Figure 3. Gas production in the CIS 22
Figure 4. Lower Levels of Economic Integration 26

List of Tables

Table 1. Intra-CIS trade (percentage of total trade) 7
Table 2. Regional trade blocs involving CIS countries 10
Table 3. Selected macroeconomic indicators 32
Table 4. GDP and trade growth since WTO accession 33

LIST OF ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
BSEC	Black Sea Economic Cooperation
CABCD	Central Asian Bank for Cooperation and Development
CACM	Central Asian Common Market
CACO	Central Asia Cooperation Organization
CAEC	Central Asia Economic Cooperation
CAREC	Central Asia Regional Economic Cooperation Initiative
CIS	Commonwealth of Independent States
CMEA	Council for Mutual Economic Assistance
CSTO	Collective Security Treaty Organization
EBRD	European Bank for Reconstruction and Development
ECO	Economic Cooperation Organization
EU	European Union
FDI	foreign direct investment
FSU	Former Soviet Union
FTA	Free Trade Area; Free Trade Agreement
GATT	General Agreement on Tariffs and Trade (later WTO)
GUAM	Georgia, Ukraine, Azerbaijan, Moldova [a regional cooperation organization]
IMF	International Monetary Fund
Mercosur	Southern Common Market (Spanish: Mercado Común del Sur)
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
NATO	North Atlantic Treaty Organization
NIS	Newly Independent States (CIS + Baltic states)
PPP	Purchasing Power Parity
RAO-UESR	Russian Joint Stock Company Unified Energy Systems of Russia
SCO	Shanghai Cooperation Organisation
TEU	twenty-foot equivalent unit
TRACECA	Transport Corridor Europe-Caucasus-Asia
UNDP	United Nations Development Programme
UNECE	United Nations Economic Commission for Europe
VAT	Value Added Tax
WTO	World Trade Organization

1 INTRODUCTION

At first hand, economic integration between the CIS countries might appear straight-forward: during over a hundred years the territories were parts of the same state – first the Russian Empire and later the Soviet Union – and they were economically well integrated.[1] Highly inter-dependent production facilities were scattered across the Soviet Union not because it was economically efficient but because it fulfilled social and economic objectives of the Soviet central government. As a consequence, the Soviet republics traded almost exclusively with each other, and the CIS countries continued to have a disproportionately high percentage of their trade directed towards neighbouring post-Soviet countries during the first few years of transition. Over time, however, this percentage has decreased significantly for most countries. Gravity model estimations indicate that the CIS countries today continue to overtrade with each other, although they still trade too little as a part of their GDP (Elborgh-Woytek 2003; Babetskii, Babetskaia-Kukharchuk, and Raiser 2003). Proportionally excessive intra-regional trade should in this case, however, not be mistaken for deep-seated integration, but rather be regarded as a lack of ability to reach out to extra-regional markets. Trade within the CIS, and the Caspian region in particular, continues to be obstructed by a multitude of barriers: complex and opaque trade policies, import tariffs, export controls, high costs from border delays, visa requirements, corruption, poor transport and transit conditions to name just a few.

Over the course of the last 15 years numerous attempts have been made to economically reintegrate the CIS countries in order to mitigate political differences and boost trade and development. Various forms of trade blocs – such as the CIS Economic Union and the Customs Union – have been established, but they have all invariably resulted in some degree of failure. In many cases, the unsuccessful attempts of CIS integration have been attributed to Russia's desire to use political and economic cooperation as a means to regain political influence in the post-Soviet space. Indeed, Russia's meddling in parliamentary and presidential elections in other CIS countries as well as discriminatory pricing of crude oil and gas have done little to increase political trust and promote economic integration. Interestingly enough, however, previous failures have not seemed to discourage the CIS countries from embarking on new projects with renewed vigour and enthusiasm. Thus, there seems to be at least a common understanding of the necessity to settle certain economic problems in an intra-regional forum, even though there is obviously considerable disagreement as to how this should be accomplished in practice.

The issue of regional integration in the CIS has attracted substantial attention among Western social scientists: quite an extensive body of literature – in economics, political science, as well as in international relations – has been produced sine the early 1990s. Many multilateral organisations, including the International Monetary Fund (IMF), the World Bank, the European Bank for Reconstruction and Development (EBRD), the United Nations Economic Commission

[1] The countries in the post-Soviet space are often collectively referred to as the Former Soviet Union (FSU) or the Newly Independent States (NIS). In this thesis, however, I will – as consistently as possible – let the Commonwealth of Independent States (CIS) represent all the FSU countries except the Baltic States, as these 12 countries are the focus of this study. Ideally, I would write "all FSU countries except the Baltic States" on every occasion in order to separate the CIS organisation from CIS as a geographic entity, but this would unquestionably become quite tiresome for the reader (and the author for that matter). Hopefully, there will be little scope for misunderstandings.

for Europe (UNECE), and countless other scientists have thoroughly and repeatedly analysed various aspects of CIS integration, particularly shifting trade flows.

The dominant normative view of CIS integration among these economists is largely neoliberal, i.e. they claim that problems of economic integration can be solved through the implementation of liberal market reforms and the removal of direct and indirect barriers to trade. Ideally, they claim, economic integration in the CIS should be pursued in a multilateral framework, namely the WTO, in order to avoid distortions to the efficient allocation of production resources. Regional integration, in their view, serves mainly as a trade-distorting obstacle conflicting with multilateral economic integration. The prevailing economic view thus promotes primarily integration with the world economy as a "first-best" solution, whereas regional integration is regarded as mostly detrimental to world welfare. This normative view largely stems from the contentious "Washington Consensus", which attempted to summarize the commonly shared policy advice themes at Washington-based institutions in the late 1980s, such as the IMF, the World Bank, and the U.S. Treasury Department.[2] Originally, the measures suggested in the strategy were believed to be necessary for the recovery of Latin America from the financial crises of the 1980s, but they have continued to be applied in developing countries.

I too believe that multilateralism coupled with full-scale market liberalisation should be the ultimate objective in the CIS. Unlike the ardent proponents of the Washington Consensus, however, I do not believe that trade liberalisation measures will help most CIS countries to become successfully integrated with the global economy within a short- to medium-term perspective. The lack of functioning institutions effectively hinders several CIS countries from embarking on the road to economic liberalisation in the first place. Faced with the binary decision between the "first-best" solution of full-scale multilateral integration and the worst case scenario of autarky it is, regrettably, likely that the authoritarian leaders of some CIS countries will choose the latter. Some, including Presidents Saparmurat Niyazov in Turkmenistan and Islam Karimov in Uzbekistan, have already opted for this path. In other cases, the problem is attributed not so much to political leaders as to the geographic isolation, economic dependency, and poor transportation infrastructure of the countries in questions. Sometimes the former and latter problems are present at the same time, as is the case in several Transcaucasian and Central Asian states.[3]

Unfortunately, the prevailing normative approach principally ignores this complex web of geographical constraints, historic legacies, political agendas, and security issues that currently seems to plague world market integration efforts in the CIS. As a result, one is left without a clear idea of how to reach the ideal state of affairs described by the advocates of the predominant economic view. In my view, the existence of a viable multilateral "first-best" solution has thus become a normative construct without support in current real-life developments in the CIS.

In this thesis, I will lay out an alternative normative proposition based on a combination of regional economic integration and neoliberalism. By combining these two development strategies I believe that the CIS countries, particularly those located far away from developed market economies, will be able to attract more investment, grow more quickly and integrate with the global economy at a higher pace than is the case absent a regional development component. Although it

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[2] The term itself was first presented in 1990 by John Williamson, an economist from the Institute for International Economics, an international economic think tank based in Washington D.C.

[3] The Central Asian states include Kazakhstan, the Kyrgyz Republic, Uzbekistan, Tajikistan, and Turkmenistan, whereas the Transcaucasian states include Armenia, Azerbaijan, and Georgia. A map of the FSU can be found in *Appendix 2*.

remains beyond doubt that regional integration has suffered a series of serious set-backs so far, I am firmly convinced that a substantial part of the problems that obstruct cooperation and development today need to be settled in a regional forum, albeit with the support of international actors.

While keeping focus on today's geopolitical, political, and economic situation in the CIS I will thus attempt to show why a regional agenda can function as an integral part of a realistic strategy for long-term development. Specifically, I will argue that **regional economic integration between the CIS countries is a welfare-enhancing development strategy and a vehicle for multilateral integration**.

1.1 Delimitations of Scope

The intention of this thesis is not to exhaustively describe the CIS economies or to provide a detailed development strategy for each state. The countries in the post-Soviet space differ immensely in terms of size, income, and level of market liberalisation to mention just a few parameters, and it would require several volumes to paint a comprehensive picture of the topic of this thesis. As a result, I will undoubtedly make myself guilty of certain unfair generalisations in this study, but I am confident that the premise of my argument remains uncompromised.

Ideally, the impact of regional trade blocs and multilateral integration on growth in the CIS should be tested in an econometric model. Had I been able to quantitatively demonstrate that regional integration indeed has more positive economic effects than multilateral integration alone, I would add significant weight to my argument. Unfortunately, such a study is all but impossible to perform in the case of the CIS.

First of all, the lack of reliable data coupled with incomplete time series and a short relevant time period for the CIS countries (10-15 years) renders such an approach difficult. The problem is not a general lack of CIS growth and trade data; in fact an abundance of statistics has become available since the end of communism, but the quality is extremely uneven. Trade data has been notoriously understated due to the avoidance of foreign trade taxes and capital flight. For long, the borders within the CIS were not controlled, and customs officers along the former Soviet external border had a reputation for being the most pervasively corrupt of all post-Soviet officials (Åslund 2002). As a result, customs statistics tend to be close to useless. Extensive shuttle trading and smuggling across all of the CIS further exacerbate the deviation of statistics from actual trade turnover.[4] Moreover, some countries collected and published information only for selected parts of foreign trade. Trade data from the beginning of the post-Soviet period are particularly poor. For these reasons, the exact value and volume of trade in the first few years of transition may never be known (UNECE 2003; Sutyrin 1996). Despite the allegedly improved data quality I have, however, found deviations of several hundred percent in trade statistics even for the most recent years.

Second, there have hitherto been rather few instances of free trade in the CIS, effectively reducing the number of applicable data points further. I conclude that a quantitative study of this kind would be difficult to perform, and that any results coming out of it would most likely be seriously flawed. As a result, the conclusions of this thesis will be largely based on qualitative assessments of previous research and theoretical models.

[4] For a detailed analysis of trade data availability in the FSU, see Freinkman et al (2004).

1.2 Outline

This thesis has a slightly unorthodox outline. However, the reader will soon be able to understand why this is. In section two, I will review the history of integration in the CIS, starting with the break-up of the Soviet Union and continuing with the trade blocs and economic cooperation agreements established since independence. I will focus on the actual outcome of these trade blocs and refrain from analysing the reasons behind the lack of integration success. In the third section, however, I will categorise the disintegrative driving forces into geographic constraints; economic legacies of the Soviet period; political and security obstacles; and political economy agendas.

In the fourth section, the theory of economic integration is presented. This section provides us with the arguments of the prevailing economic theory against regionalism as opposed to multilateralism. In the fifth section, I seek to explain why the critique of regional integration is not completely applicable in the CIS, and why the prevailing economic agenda alone is not the answer to integration and development problems in the CIS. I advance a combination of regionalism and multilateralism as a realistic and sustainable way forward for the CIS's southern-tier countries. In the last two sections, I will conclude my findings and make a few suggestions for future research.

2 Background: The History of CIS Integration

A series of attempts have been made at economically integrating, or, perhaps more accurately, reintegrating, the CIS countries during the years that have passed since independence. These integration efforts have been driven by a desire to boost economic development through increased trade, but occasionally also to fulfil more opaque political and security-related agendas. Indeed, several cooperation organisations have been initiated by Russia as a means to preserve influence in the post-Soviet space, whereas others have deliberately strived to exclude Russia.

One common feature of integration projects in the CIS is that they have been unable to fulfil their stated objectives; the volume and scope of trade is still a far cry from the pre-1991 levels, and political trust remains low in many parts of the CIS. A significant part of the current integration problems can, as I will show in the subsequent section, be attributed – directly or indirectly – to the legacies of the Soviet command economy. The break-up of the Soviet Union sent shock waves through the economies of the republics, causing massive drops in GDP and forcing inefficient industries to redirect production. In order to understand today's political and economic landscape in the CIS, and, in turn, the failure to establish functioning regional trade blocs, a few aspects of the break-up of the Soviet Union need to be highlighted. Thereafter, I will briefly review the trade blocs, which have been established since independence.

2.1 The Break-up of the Soviet Administrative Command Economy

The Collapse of Intra-Soviet Trade Links

The Soviet administrative command economy differed profoundly from the Western market-based economic structure; "enterprises" in a market economy sense were all but non-existent in the Soviet Union. Rather, Soviet enterprises could be described as "production units", which often comprised an array of different activities. For example, a large industrial plant could also run its own farms, schools, bread factory etc. Enterprises were budget financed to the extent that profits flowed into the state budget, shortfalls were covered by subsidies, and investment financed was provided from the budget (Gregory and Stuart 2001). Domestic prices in the Soviet Union were not established through supply and demand in the goods markets. Rather, they were more or less arbitrarily determined by the government. Any attempt at calculating the economic profit of a Soviet enterprise through the cost of supplies and the price of output would thus be rendered meaningless.[5]

Unlike the transition countries in Eastern Europe, Russia and the other newly independent states comprised a single large country, organised as an integrated administrative command economy under a single dominant Communist Party but with significant regional differences. As a consequence, the transition of the FSU brought with it a set of problems, which were more complex than in the Eastern European transition economies. For example, the break-up of the Soviet economy meant that traditional suppliers were suddenly located in independent countries, often without established means of payment or even communication. The "gigantomania" of Soviet production planners had left a vulnerable legacy: many large plants depended on one dominant supplier for some of their raw materials or intermediate goods and, analogously, had one dominant purchaser. When one such gigantic plant ceased to operate, others were left without supplies or without customers (Leijonhufvud 1993). New channels of supply and new means of payment and clearing had to be developed.

In addition to the issue of concentrated suppliers, the break-up of the Soviet economy also broke up a formerly unified transportation system into national parts, requiring regulation, direction, and agreement. The oil and gas pipeline system, for example, typically ran from the oil- and gas-producing regions of Siberia and Central Asia to ports located either in Russia or in the Baltic states. Suddenly pipelines crossed national borders, and tariffs and taxes had to be paid where none had been collected before. Methods had to be worked out for common maintenance procedures. Transit countries could block access in order to gain political concessions, creating international political problems that had not existed earlier.

Political uncertainty about rights of way or political stability also prevented the construction and expansion of transportation facilities that crossed new national boundaries. Moreover, the 15 republics had to create infrastructure within a short period of time at below-optimal scales of output. For example, each republic had to create its own telephone system, airlines, and haulage fleet.

The intra-Soviet-republic trade conducted in domestic prices that deviated substantially from world market prices was also brought to an end in the early 1990s. In the Soviet Union, enterprises in the republics purchased energy at the subsidised domestic wholesale price. Buyers from outside the Soviet Union, on the other hand, paid world market prices of energy and raw materials. Intra-Soviet-republic trade therefore involved implicit subsidies from one republic to another, since enterprises received products through the centralised supply system at prices below world market prices (Gregory and Stuart 2001). For example, in 1991 the domestic wholesale price in the Soviet Union fell to less than half a percent of the world market price, calculated at the free exchange rate (Åslund 2002). After the break-up, the CIS countries purchased oil from Russia at about 5 percent of world market prices (Olcott, Åslund, and Garnett 1999).

[5] Much has been written about the peculiarities of the Soviet administrative command economy, and this section is not an attempt to provide an exhaustive overview of this literature. For more detailed accounts of the Soviet economy, see, for example, Åslund (2002), Gregory and Stuart (2001), and Hanson (2003).

Trade and Exchange Rate Policy

Just as in the case of general economic policy, the Soviet foreign trade system was very different from those typically found in market economies. Foreign trade was conducted through the planning system and the centralised state trading organisations. Tariffs, quotas, and non-tariff barriers were thus not formally required. Although there were efforts to change this system during perestroika,[6] fundamentally the Soviet Union remained economically isolated from world market influences. The Soviet Union attempted to promote economic integration with the socialist countries of Eastern Europe through the creation of the Council for Mutual Economic Assistance (CMEA) in 1949. These arrangements were intended to integrate the planned socialist systems of Eastern Europe with the Soviet Union through the specialisation of trade and production among member countries. Trade with the CMEA members accounted for more than 50 percent of Soviet foreign trade throughout the post-war era.[7]

Soviet trade with capitalist countries increased significantly after World War II, from roughly 19 percent of total trade in 1950 to 35 percent in 1988. By the mid-1980s, the Soviet Union had a trade volume in hard currency of roughly $50 billion. The bulk of trade was conducted with developed capitalist countries, particularly West Germany, France, Italy, and Japan. However, the East bloc had problems competing in Western markets with processed goods due to problems of quality and the inability to meet the service requirements that these markets demanded. As a result, the Soviet Union delivered mostly unprocessed natural resources to Western markets. In the 1980s, Soviet hard currency exports were thus dominated by oil and oil-related products, natural gas, and military hardware. On the import side, agricultural products accounted for roughly one-third of hard currency imports (to compensate for the under-production in the severely dysfunctional Soviet agriculture), while machinery and equipment, chemicals, metals, and fuels accounted for the remainder. There was, however, a balance of payments problem in the Soviet trade with the West related to the fact that (in the absence of credits) purchases from the West were limited to the amount of sales to the West. Unlike Western countries, the administrative command economies could not pay for imports with their own, non-convertible currencies.

Pre-transition reforms[8] introduced multiple exchange rates for different goods, which effectively functioned as foreign trade taxes. With the transition came a – usually gradual – unification of the exchange rate. The number of exchange rates differed between the transition countries. In most CIS countries convertibility was initially limited by government requirements that exporters give up part of their hard currency revenues at different exchange rates to the central bank, to commercial banks, or on the domestic currency market (Gregory and Stuart 2001). The requirement of the repatriation of a certain share of export revenues has persisted in many countries.

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[6] "Perestroika" is the Russian word for the economic reforms introduced in June 1987 by the Soviet leader Mikhail Gorbachev. Its literal meaning is "reconstruction", which refers to the restructuring of the Soviet economy.

[7] The CMEA was founded by the Soviet Union, Bulgaria, Czechoslovakia, Hungary, Poland, and Romania, and later came to include as full members also the German Democratic Republic (East Germany), Cuba, the Mongolian People's Republic, and Vietnam.

[8] Although there is a wide variation in terminology, *reform* frequently refers to attempted changes from within, leaving the political entity unchanged. *Transition* refers to the replacement of one economic system by another economic system, in the 1990s typically the replacement of plan by market. So defined, one normally thinks of Soviet economic reform as beginning with a variety of modifications to planning arrangements introduced by Nikita Khrushchev in the 1950s.

In most transition countries, including the CIS, foreign trade regulation and taxation had remained highly discretionary until the demise of communism, but with the unification of exchange rates foreign trade assumed a real role. The liberalisation of imports was fast in all reformist countries. Import quotas and licenses became exceptions, and rather low import tariffs were introduced in their place. Russia had no tariffs during the first half of 1992, and Estonia abolished them altogether. However, three international organisations encouraged countries to raise import tariffs to 10-15 percent. The International Monetary Fund (IMF) advocated low and uniform import tariffs as a good means of collecting state revenues. The European Union (EU) encouraged the countries aspiring to join the EU to raise their tariffs to a level at least as high as those of the EU. For entry negotiations with the World Trade Organisation (WTO), it was perceived as necessary to have at least some import tariffs so as to be able to reduce them in negotiations (Åslund 2002).[9]

After a few years, real exchange rates had appreciated as the financial situation stabilised, and domestic producers started to experience foreign price competition. As a result, they demanded raised import tariffs and the introduction of quotas. In the truly liberalised countries in Central Europe and the Baltics, the resistance against protectionism was strong enough to keep the advocates of higher tariffs at bay, thus keeping import tariffs at 10-15 percent. In other countries, strict import protection measures were adopted with tariffs on certain goods exceeding 100 percent.

Table 1. Intra-CIS Trade (percentage of total trade)

	1990	1992	1994	1996	1998	2000	2002	2003
Azerbaijan	92%	55%	53%	40%	38%	21%	23%	23%
Armenia	97%	-	60%	35%	28%	21%	27%	22%
Belarus	89%	-	64%	66%	69%	66%	62%	63%
Georgia	91%	-	79%	45%	35%	37%	43%	39%
Kazakhstan	89%	-	60%	60%	43%	37%	32%	32%
Kyrgyz Republic	97%	80%	66%	66%	50%	48%	46%	47%
Moldova	93%	69%	72%	64%	52%	43%	45%	46%
Russia	64%	-	24%	23%	22%	19%	17%	18%
Tajikistan	82%	58%	31%	50%	50%	64%	50%	44%
Turkmenistan	96%	-	65%	61%	39%	-	-	-
Ukraine	82%	63%	64%	58%	44%	44%	38%	38%
Uzbekistan	89%	-	58%	27%	26%	-	-	-
Total Intra-CIS Trade		**63%**	**36%**	**35%**	**31%**	**28%**	**25%**	**26%**

Sources: Havrylyshyn and Al-Atrash (1998, p. 14) for 1990 data; Interstate Statistical Committee of the CIS (2004).

The shift in trade after independence has been away from the CMEA countries and towards the Western industrialised countries. As late as 1991, Russia's primary trading partners were the republics of the former Soviet Union. However, the flows of goods and services changed markedly within just one year's time. In 1991, 67 percent of Russia's exports were to republics of the former Soviet Union. By 1994, this percentage had shrunk to 24 percent, and it has stayed around 20

[9] The early pressure to raise import tariffs thus ironically initially came from international organisations. Only later did domestic protectionist forces gain significant influence.

percent since. In *Table 1*, the share of the CIS countries' trade with other CIS members is displayed.[10]

The Ruble Zone

The development of a new trading system in the post-Soviet space also required the development of a new payment system. In the Soviet block a fictitious currency called "transferable ruble" had been used as unit of account for bilateral clearing. A necessary component in a well-functioning payments system is credit lines. In the old Soviet system, however, there was no attempt to balance trade flows within the Soviet Union. In 1991, even at old, subsidised Soviet prices, Russia had a trade surplus towards the other republics of approximately $25 billion. Price liberalisation would have improved Russia's terms of trade dramatically, since a large share of Russia's exports comprised commodities being sold at low prices. This trade imbalance made it seem inevitable that Russia, at least initially, would have to provide most of the CIS states with trade credits (Olcott, Åslund, and Garnett 1999).

The costs for Russia of this system were staggering, and calls for the nationalisation of the Russian currency were voiced as early as during the summer of 1991. Several of the new states considered introducing their own currencies, but they were unwilling to give up the subsidies offered by Russia. At the end of 1991 there were 15 republican national banks, each independent of the other, which were all issuing ruble credits. One of the consequences was that, at the end of 1993, ten of the twelve CIS member states suffered hyperinflation, meaning inflation of at least 50 percent per month (Hanson 2003). According to IMF estimates, Russia financed 91 percent of Tajikistan's GDP in 1992, and Uzbekistan obtained financing corresponding to 70 percent of its GDP from Russia.

The financial situation which resulted was impossible: hyperinflation prevailed; most CIS currencies had multiple exchange rates, with official rates deviating from market rates; the rubles of various countries had different values and could not be exchanged; Russia gave big state credits, but they were automatic, since they arose from trade deficits. Gradually, Russia started to impose credit limits on the other CIS countries. Russia's efforts to limit access to ruble banknotes and credits prompted other states to issue quasi-currencies and, eventually, real national currencies (Olcott, Åslund, and Garnett 1999). In July 1993, Russia declared the old Soviet banknotes to be invalid. Before the end of 1993, virtually all countries had left the Ruble Zone and established their own currencies. Inflation soon started to fall throughout the region.

Sensing the approaching failure of the Ruble Zone, Russia advocated the formation of a payments union. An Inter-State Bank was proposed and subsequently endorsed by seven of the CIS countries in January 1993. However, in May 1995, the Inter-State Bank was formally abandoned in favour of the bilateral settlement of CIS interstate payments in dollars. Barter and similar decentralised non-monetary payments accounted for roughly one-tenth of all payments between 1993 and 1995, primarily representing payments to Russia's natural gas monopoly, Gazprom. Payments in hard currency expanded from a 5 percent share in 1993 to 15 percent in 1995, but then fell again as national currencies stabilised and gained certain convertibility. On

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[10] There are significant differences in the data for intra-CIS trade in Havrylyshyn and Al-Atrash (1998) and the Interstate Statistical Committee of the CIS (2004) in 1992, 1994 and 1996. In *Table 1*, I have used Havrylyshyn and Al-Atrash for the 1990 data and the Interstate Statistical Committee of the CIS data for all subsequent years.

average, barter trade represented an estimated 10 percent in 1997 (Åslund 2002). The barter that remains in intra-CIS trade is concentrated in a few major commodities, notably natural gas.

2.2 Regional Integration Projects after Independence[11]

The de facto end of the Soviet Union was declared on 8 December 1991, when the presidents of Russia, Ukraine, and Belarus formed the Commonwealth of Independent States (CIS). The leaders declared that the Soviet Union had ceased to exist as a subject of international law and geopolitical reality. After considerable disagreement Russia became the legal successor of the Soviet Union and the guarantor of the foreign creditor agreements of the CIS member states.[12]

The CIS was expanded to include eleven of the FSU countries at a meeting in the then Kazakhstan capital of Almaty on 21 December 1991. The Baltic countries and Georgia were the only countries that declined to attend. The stated goals of the CIS were straightforward: to coordinate foreign and security policies, to develop a common economic space with a common customs policy, to maintain orderly control over the military assets of the FSU, to develop shared transportation and communications networks, to preserve the environment and maintain environmental security, to regulate migration policy, and to take coordinated measures against organised crime (CIS 1991).

In 1994, the CIS countries created a free-trade zone and a payments union. The goal was to establish a comprehensive mechanism by which the CIS countries could conduct trade with each other in the wake of the collapse of the Ruble Zone in 1993. This, in turn, was supposed to boost trade turnover, which had plummeted after the break-up of the Soviet Union. As it turned out, however, very few of the institutions and trade agreements set up in the CIS framework had any real effect on trade relations; the CIS countries continued to define themselves foremost as entities in the world community and they refused to surrender any decision-making power to supra-national authorities. The economic, political, and military dominance of Russia in the CIS organs served to strengthen the other member countries desire to seek allies and trade partners outside the post-Soviet space.

In 1995, Belarus, Kazakhstan, and Russia formed the Customs Union. The group was later joined by the Kyrgyz Republic. The purpose of the Customs Union was to move ahead with economic integration as it became clear that the CIS free-trade zone had completely lost momentum. Over the following years, however, the Customs Union made little progress in solving mutual problems, including the harmonisation of tariff policies and trade nomenclature. In 2001, the Customs Union member states together with Tajikistan decided to launch a new and much broader economic cooperation: the Eurasian Economic Community (EEC). Moldova joined as an observer in 2002 and Uzbekistan became a full member in 2006 after that country had officially left the GUAM organisation. As in the case of the Customs Union, real progress in the EEC has been halted due to disagreements over tariffs and trade policies.[13]

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[11] A more detailed overview of the trade agreements set up in the CIS framework is provided in *Appendix 1*. See also Sushko (2004) and UNDP (2005).

[12] Russia also took over the position of the Soviet Union in several other areas, such as the UN Security Council and other international organisations. Also, Russia remained the only FSU country with nuclear weapons, after these had been moved from bases across the FSU to Russian military installations in the early 1990s.

[13] For an excellent overview of the harmonization of tariffs in the EEC and the progress towards freer trade in the CIS region, see UNECE (2005).

In Central Asia, a series of regional cooperation agreements have been established. In 1994, the presidents of Kazakhstan, Uzbekistan, and the Kyrgyz Republic agreed to make a common economic space of their countries – the Central Asian Economic Community (CAEC) – and they founded the Central Asian Bank for Cooperation ad Development (CABCD). War-torn Tajikistan was accepted as a member of the organisation only in 1998, whereas Turkmenistan has refused to join. The scope of cooperation was extended when the failed CAEC was replaced with the Central Asian Cooperation Organization (CACO) in 2002. Regrettably, the CACO was not significantly more successful in fostering cooperation between the Central Asian countries; security concerns, political distrust, and slow economic growth obstructed all efforts to integrate. Russia joined the CACO in 2004, which dramatically shifted the centre of gravity in the organisation, and it came as no surprise when CACO was formally absorbed by the Russia-dominated EEC in October 2005.

Table 2. Regional trade blocs involving CIS countries

Organisation	Year of Establishment	Member States
Commonwealth of Independent States (CIS)	1991	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan (associate member), Ukraine, Uzbekistan
The Customs Union†	1995	Belarus, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan
Eurasian Economic Community (EEC)	2000	Belarus, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan, Uzbekistan
Central Asian Cooperation Organisation† (CACO)	2002	Kazakhstan, Kyrgyz Republic, Russia, Tajikistan
GUAM	1997	Georgia, Ukraine, Azerbaijan, Moldova
Russia – Belarus Union	1999	Belarus, Russia
Single Economic Space (SES)	2003	Belarus, Kazakhstan, Russia, Ukraine
Black Sea Economic Cooperation (BSEC)	1992	Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia and Montenegro, Turkey, Ukraine
Economic Cooperation Organisation (ECO)	1992	Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan, Turkmenistan, Uzbekistan

† No longer existing

Georgia, Ukraine, Azerbaijan, and Moldova founded the GUAM organisation in 1997 in order to enhance regional cooperation in trade, transportation, and security. In 1999, Uzbekistan joined GUAM, but it left again in early 2006. Joined by their desire to counterbalance Russian influence in the region, the GUAM members have effectively used the organisation as a forum in a number of areas, particularly security-related issues. In 2002, the member states decided to establish an FTA across their territories, but this proposal has found little real parliamentary support. The development of cooperation within GUAM has arguably further undercut the institutional authority of the CIS.

The most ambitious integration attempt in the CIS is the Russia-Belarus Union. A series of agreements were concluded between the parties in the mid-1990s, and customs checkpoints along the border were removed in 1995. A draft treaty in 1997 proposed to create a formal union between the two countries, but it was not until 1999 that the Treaty on the Formation of a Union State was signed and ratified. While one of the main objectives of the Union was deeper economic integration, the main integration development has taken place in the area of defence and security. The proposed monetary union has been delayed several times, and the introduction of a common currency is now set to 1 January 2008.

The Single Economic Space (SES) was created in 2003 by Belarus, Kazakhstan, Russia, and Ukraine. The objectives of the member countries when setting up the SES varied considerably. Russia and Belarus were aiming at establishing a customs union and a monetary union based on the Russian ruble, whereas Ukraine rejects the idea of a monetary union as this is in conflict with the country's strategic pro-EU objectives (UNDP 2005). Ukraine thus wishes to limit its participation in the SES to the FTA, the only objective considered compatible with its constitution. The SES is intended to be administered by a single regulatory body, the decisions of which will be obligatory to the member states, but the idea has met considerable opposition. The progress within the SES ground to a halt when the pro-Western candidate Viktor Yushchenko was elected president in Ukraine in 2004.

A number of international organisations, in which certain CIS countries have become members, have also issued plans to establish FTAs or preferential trade agreements. For example, the Black Sea Economic Cooperation (BSEC) was established in 1992, and aims to enhance regional cooperation in several areas, including trade, energy, and investment. Although the organisation has been active for over 10 years, few concrete results have been achieved.

The Economic Cooperation Organisation (ECO) was created in 1985 by Iran, Pakistan, and Turkey on the basis of the Regional Cooperation and Development Organisation. The ECO had no real function until 1992, when it invited as members the six CIS states with predominantly Muslim populations, namely Azerbaijan, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. Afghanistan also became a member of the ECO in 1992. The organisation aims to promote conditions for sustainable economic development; to raise the standard of living and quality of life in the member states through regional economic cooperation, the progressive removal of trade barriers within the ECO region, and the expansion of intra- and inter-regional trade. The group's general goal was to create a version of the EU for the Muslim states of the region. The five Central Asian countries, together with Afghanistan and Azerbaijan, have expressed commitment to ECO principles, but have so far made no moves towards preferential tariffs (UNDP 2005).

3 IDENTIFYING THE OBSTACLES TO CIS INTEGRATION

It is no exaggeration to say that the integration projects attempted since independence in the CIS have failed by most accounts; not only have the CIS countries been unable to establish any functioning trade bloc, they have clearly demonstrated that there is little scope for any political trust. Moreover, the CIS countries have largely been unsuccessful in integrating with the world economy. In every year since the creation of the CIS, the member states' volume of trade with the outside world has increased much faster than has their trade with one another, but, according to gravity model estimates,[14] CIS countries, particularly in Central Asia, overall still trade less than one

[14] The gravity model was first applied by Jan Tinberger in 1962 on the flows of bilateral trade based on analogy with the law of gravity in physics: $Tij = AYiYj\ /Dij$, where Tij is exports from country i to country j, Yi,Yj are their national incomes, Dij is the distance between them, and A is a constant. Other constants as exponents and other variables are often included (Brakman, Garretsen, and van Marrewijk 2001).

might predict given their size, income levels, geographical distance, and exchange rate volatility (Babetskii, Babetskaia-Kukharchuk, and Raiser 2003; Fidrmuc and Fidrmuc 2000).

But why, then, have regional integration attempts been so unsuccessful? From a purely practical and administrative point of view one significant obstacle to regional integration (but only indirectly to world market integration) is the sheer number of regional and bilateral agreements that have been drawn up since 1991. Apart from the FTAs, customs unions and monetary unions, there are many bilateral preferential trade agreements in the CIS. These overlapping agreements – each with different product coverage and exemptions as well as rules of implementation – have resulted in what trade literature calls a "spaghetti bowl" effect (Bhagwati 1995; Bhagwati, Greenaway, and Panagariya 1998; Abugattas Majluf 2004) of numerous and crisscrossing trade agreements and innumerable applicable tariff rates depending on arbitrarily defined and often a multiplicity of sources of origin (see Figure 1 and Appendix 5). This effect leads to a conflicting and confusing set of trade policy rules at any given border: 'The multiplicity of regional organisations with almost identical goals and objectives and the appearance of various institutions for regional integration of Central Asian states have led to fragmentation of political and economic systems within the region, and to a stretching and irrelevance of the limited administrative mechanisms and decision-making mechanisms across Central Asia' (UNDP 2005, p. 56). Indeed, when administrated unjustly, inefficiently, and corruptly, borders are costly diversions of resources that drain opportunities for growth and prosperity.

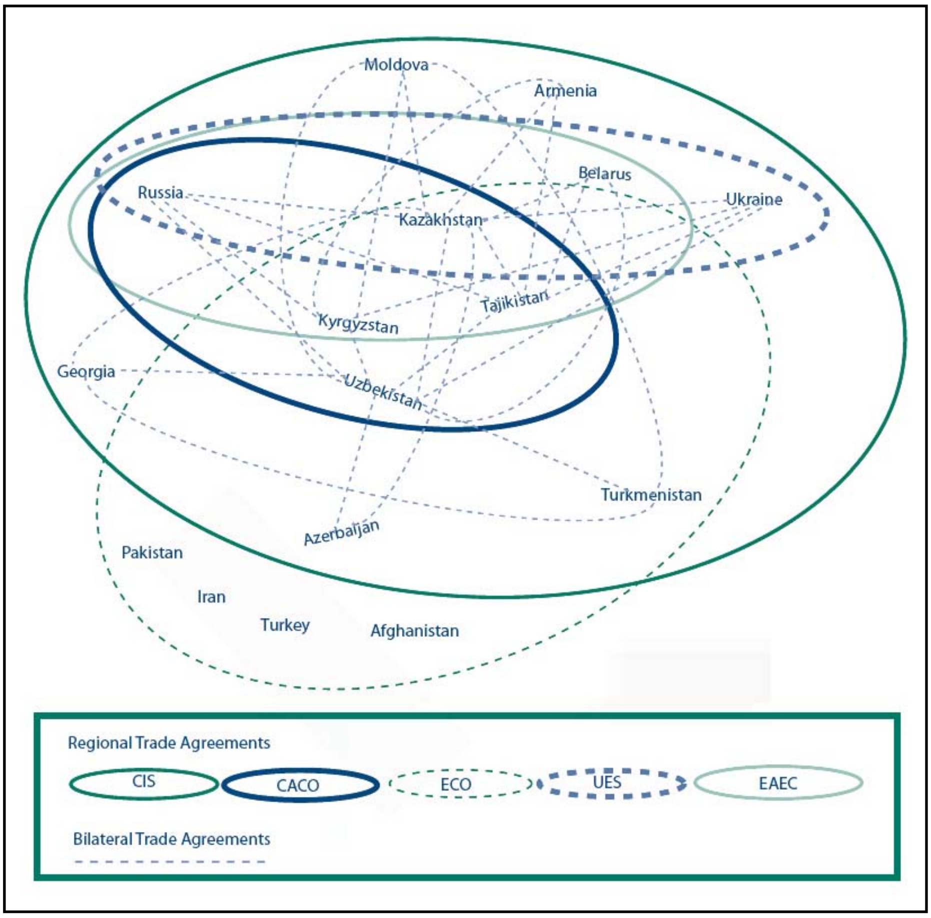
However, despite the complex repercussion of overlapping trade agreements, it cannot be argued that this is actually the most important reason as to why regional integration has failed in the first place. For sure, with every additional trade agreement between two states – be it bilateral or multilateral – the contracting parties demonstrate their lack of will to actually implement any trade-enhancing measures; if the last agreement was not implemented, why should we expect the next one to be executed? Even so, there are more deep-rooted obstacles to integration in the CIS. The failure to establish regional trade blocs is, in my view, merely a manifestation of more fundamental problems, which cannot be solved through political rhetoric. In reviewing the CIS trade blocs it becomes clear that each integration effort has failed because of its own unique set of factors; geopolitics, economics, ethnic and national antagonism, security agendas, and historic legacies are all intertwined in a seemingly impenetrable web of confusion and distrust.

In the literature on CIS integration several explanatory factors have been advanced and tested, albeit with varying results. Both Babetskii, Babetskaia-Kukharchuk, and Raiser (2003) and the EBRD (2003) conclude that the relatively poor quality of institutions as measured by the World Bank's governance indicators for regulatory quality, rule of law and control of corruption, were a major obstacle to CIS trade. Furthermore, EBRD finds that the combination of geographical constraints,[15] border controls, restrictive trade policies, and weak institutions explain almost entirely its lack of integration in the world economy, whereas Babetskii, Babetskaia-Kukharchuk, and Raiser (2003) point out geographic isolation, high transport costs due to inadequate transport infrastructure, borders, and the low quality of governance as the main obstacles to trade in the CIS area. According to the EBRD, the CIS countries – were they to adopt the trade policies of the new EU member states and become WTO members – would increase their level of trade with the

[15] EBRD (2003) defines geographical constraints as the size of the country, working under the assumption that larger countries face higher internal transport costs and may therefore trade less.

world economy by around 20 percent. If they had the same quality of governance as the new EU member states, trade would almost double according to the same model.

Figure 1. The spaghetti bowl effect of regional and bilateral trade agreements involving the CIS countries (as of August 2005)



Source: UNDP 2005, p. 57

Elborgh-Woytek (2003) attributes the lower-than expected trade in the CIS to slow progress in transition, trade restrictions, geographic and topographic features, weaknesses in physical infrastructure, corruption problems in customs and transport services, political tensions among the CIS countries, and restrictions to market access on the part of major trading partners such as the EU and the USA.

On the basis of these results, it seems reasonable to divide the obstacles to CIS trade (whether it be within the CIS region or the world outside) into three aggregated general categories: geographic constraints; economic legacies of the Soviet period; and political and security obstacles. A similar division has been made by Bartlett (2001) in his study of economic development strategies in the NIS. However, unlike the research papers mentioned above, I am interested primarily in the reasons for failed *integration* and not just lack of *trade*, which widens the scope of the problem. Admittedly, trade is a key proxy for economic integration, but particularly in the case of the CIS there are other and potentially more important areas in which cooperation might serve economic ends without actually involving trade of goods or services. In particular, the geographic isolation of the Caspian region requires regional cross-border cooperation in order to enable integration with more remote and profitable markets and eventually to enhance growth. Such cooperation calls for a number of measures including coordination of infrastructure investments and efficient water management, which have a direct effect on integration and economic growth but only an indirect effect on trade. I will thus slightly widen the categories above and add a fourth category: political economy agendas, the importance of which in a CIS context is emphasised, among others, by Afontsev (2005). The effects of political economy are difficult to measure and to capture in a gravity model, but its significance for integration efforts should not be underestimated.

These four categories are, in some cases, slightly overlapping, but combined they paint a fairly comprehensive picture of the complex of integration problems in the CIS. Only by addressing all of these problems will the CIS countries be able to successfully integrate their markets, and, in a longer perspective, gain real access to global markets. Before it can be appreciated why the prevailing economic theory along the lines of the Washington Consensus alone falls short of providing a useful development strategy for the CIS and why regionalism could still be a viable option for this region, it is useful to briefly look at how these basic problems have been dealt with during the last 15 years.

3.1 Geographic Constraints

The link between geography and development is an old theme; in the late eighteenth century Adam Smith noted the rise of advanced economies in Europe's seafaring regions and lagging development in inland states (Bartlett 2001). On the issue of transportations costs in landlocked regions, Smith wrote that:

> All the inland parts of Africa, and that part of Asia which lies any considerable way north of the Euxine [Black] and Caspian seas, the antient Sycthia, the modern Tartary and Siberia, seem in all ages of the world to have been in the same barbarous and uncivilized state in which we find them at present. The sea of Tartary is the frozen ocean which admits of no navigation, and though some of the greatest rivers in the world run through that country, they are at too great a distance from one another to carry commerce and communication through the greater part of it. There are in Africa none of those great inlets, such as the Baltic and Adriatic seas in Europe, the Mediterranean and Euxine seas in both Europe and Asia, and the gulphs of Arabia, Persia, India, Bengal, and Siam, in Asia, to carry maritime commerce into the interior parts of that great continent . . . (Smith [1776] 1976, p. 25)

The difficult geopolitical situation of many CIS countries has thus been identified as a serious obstacle not only to regional integration, but also as one of the main reasons of the Central Asian and Transcaucasian states' failure to integrate with the world market. Not only are these countries located very far from key markets in Europe, North America, and East Asia, but with the exception of Georgia, Ukraine, and Russia all CIS countries are landlocked. Also, large parts of eastern Russia are effectively landlocked because of the mere size of the country.

Being landlocked does not necessarily doom a country to economic backwardness, but the few examples of states that have succeeded in overcoming that geographic barrier (for example, Switzerland and Austria) are located in the middle of well-functioning regional markets (Bartlett 2001). There are 35 landlocked countries in the world with population greater than 1 million, of which 29 are outside of Western and Central Europe. Of these 29 countries, the richest is 38th, Botswana, which owes it relative success to well managed diamond mines. The second richest is 68th, Belarus. The difference in means is striking: in 1995, the landlocked countries outside of

Western and Central Europe had an average income of $1,771, compared with the non-European coastal countries, which have an average income of $5,567 (Gallup, Sachs, and Mellinger 1999). Since 1995, the world's landlocked countries have become relatively even poorer.[16]

Gallup, Sachs, and Mellinger further show that geography remains important for economic development, alongside the importance of economic and political institutions. In particular, they find that landlocked economies may be particularly disadvantaged by their lack of access to the sea, even when they are no farther than the interior parts of coastal economies, for at least three reasons: (1) cross-border migration of labour is more difficult than internal migration; (2) infrastructure development across national borders is much more difficult to arrange that similar investments within a country; and (3) coastal economies may have military or economic incentives to impose costs on interior landlocked economies.

The situation of the Central Asian and Transcaucasian states contrast markedly with that of landlocked former socialist states in East and Central Europe (Hungary, Slovakia, and the Czech Republic), whose proximity to Western Europe has enabled integration with large markets. Further handicapping the countries along the CIS's southern tier is the unforgiving topography. The Kyrgyz Republic, Tajikistan, and the Transcaucasian countries are heavily mountainous, while large parts of Uzbekistan, Turkmenistan, and Kazakhstan consist of deserts. For other CIS countries, including Ukraine, Belarus, western Russia, and Moldova the problem of geographic isolation is apparently much less pressing due to the propinquity of this region to the EU.

Unsurprisingly, Radelet and Sachs (1998) find that geographical considerations – specifically access to the sea and distance to major markets – have a strong impact on shipping costs, which in turn influence success in manufactured exports and long-run economic growth. Their evidence suggests that countries with high shipping cost will find it significantly more difficult to advance export-led development, even if they reduce tariff rates, remove quantitative restrictions, and follow prudent macroeconomic policies along the lines of the Washington Consensus recommendations. Moreover, they find that the required offset in wages might be quite substantial in the usual case for developing countries in which imported inputs constitute a high proportion of the value of exports. In such sectors, high transport costs can easily eliminate export profitability even if wage levels were to fall to zero, which is clearly not a viable option. As a result, geographically remote countries may not realistically be able to replicate the East Asian model of rapid growth based on the export of labour-intensive manufactures.[17]

The consequence of isolating geographical and topographical features is that all goods going in or out of the Caspian region, i.e. the countries around the Caspian Sea, must cross long distances, undertake large portions of the journey by land, and contend with harsh terrain before reaching their final destination. These geographic constraints are, in my view, the most important stumbling-block on the road to world market integration for the CIS countries. The average cost for developing countries' exports, as a group, is about 8.6 percent of the total value of the goods, whereas the cost from landlocked countries is approximately 14.1 percent (Molnar and Ojala

[16] According to PPP-adjusted GDP per capita estimates from the CIA in 2004, Botswana is the 87th richest country in the world in terms of GDP per capita, whereas Belarus is the 104th richest (CIA 2004). Gallup, Sachs, and Mellinger (1999) use PPP-adjusted GDP data from 1995.

[17] Radelet and Sachs (1998) use Mongolia, Rwanda, Burundi, and Bolivia as examples of remote countries (since, once again, there is no data readily available for our region of interest), but the countries of Central Asia and Transcaucasia fall into the same group of landlocked countries.

2003).[18] According to World Bank estimates, transport can add around 15 percent to the cost of goods shipped to and from Central Asia, and up to 50 percent in Transcaucasia for certain commodities. The costs of trade within the region are particularly high, and transit costs are further increased by the lack of mutual recognition of customs clearance forms and other administrative practices.

On the import side, the transportation cost raises the prices of all goods coming in to the region. Radelet and Sachs (1998) conclude that coastal economies (in the CIS region meaning Russia, Ukraine, and Georgia) often have no interest in supporting economic development in the landlocked country (and may even have an interest in hindering development), for geo-strategic reasons. As a consequence, consumers in the Caspian region cannot afford to purchase imported goods unless it has a high value in relation to the cost of transportation. For example, advanced and expensive technology such as computers and medical equipment will continue to be imported, whereas bulky goods with relatively low value such as grains, ore, and timber cannot be profitably imported, at least in the absence of extremely high barriers to intra-regional trade. Also, goods requiring speedy transportation in specially designed containers such as food and dairy products are difficult to import. Demand for locally produced goods thus continues to dominate in many industries.

On the export side, the results are analogous: local producers cannot compete efficiently in markets outside the region in which they are located. Geographic isolation and higher shipping costs make it significantly more difficult if not impossible for relatively isolated developing countries to succeed in promoting manufactured exports. Firms from such countries will likely have to accept smaller returns on capital to compensate for higher shipping costs (Radelet and Sachs 1998). The fact that most countries in the southern-tier CIS are historically geared towards production of primary commodities and other low-processed goods (see Appendix 7) serves to exacerbate the problem.

In the road sector, truckers face high traffic charges and additional unofficial demands from numerous traffic police checks. The cost of transporting one twenty-foot equivalent unit (TEU) from Yerevan in Armenia to Bandar Abbas in Iran is $1,700 for 2,800 kilometres, while the cost from Yerevan to the port of Poti in Georgia is $1,845 for just 650 kilometres.[19] Kyrgyz truck drivers claim that they pay approximately $1,500 per truck in unofficial payments in transit through Kazakhstan to Russia. Armenian truck drivers have to pay $1,800-2,000 to the Ministry of National Security for transport to Russia through Georgia to protect them from the traffic police and organised crime (Molnar and Ojala 2003). Additionally, it is estimated that only 25 percent of roads in the Kyrgyz Republic and 20 percent of all roads in Tajikistan are in good condition (UNDP 2005). Significant problems with poorly maintained roads exist in Transcaucasia as well.

Another recent case study shows that while Georgia can produce high-quality apple juice concentrate at a competitive price, the transport cost of one TEU to a European port from Georgia can be as high as $3,000. The cost of transporting the same TEU from China is just $1,500 and transport arrangements are much more dependable there as well. As a result, transport costs are effectively driving Georgian apple juice out of the market (UNECE 2005). And then it has to be remembered that Georgia, unlike most CIS countries, at least has access to domestic sea

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[18] Costs based on free on board (FOB) rates and not considering the total costs including the most costly land transportation leg.

[19] One TEU represents the cargo capacity of a standard container 20 feet long, 8 feet wide, and (usually) a little over 8 feet high.

harbours.[20] UNDP (2005) shows that there is a serious asymmetry in transportation costs for shipments between Central Asia and Europe: it costs \$8,500 to \$10,500 to ship a truckload of cargo from the Benelux countries to Central Asia, and only \$6,000 to \$7,000 to ship in the opposite direction. This is due to the particular trade composition of trade between Europe and Central Asia. Whereas exports from Central Asia to Europe mostly consist of primary commodities transported by rail and through pipelines, imports from Europe to Central Asia chiefly consist of high-value manufactured goods transported by road and air. The total loss in Central Asia due to this problem is estimated to stand at around \$300 million per year.[21] The high transportation costs thus undermine the competitiveness of Central Asian and Transcaucasian countries' exports in international markets, raise the costs of imports, impede international trade, and deprive the region of potential trade benefits.

Local producers cannot increase their sales and achieve greater economies of scale unless the purchasing power in the region increases or the cost of transportation is significantly reduced. The solution to the former problem is to further increase productivity in domestic industries through the introduction of novel technology and the removal of administrative red tape, which is a cumbersome process in a corrupt region with extremely limited investment capital. The dilemma is apparent: the region will not be attractive to foreign investors unless the market is expanded, but the purchasing power in the region cannot be increased without raised productivity. The Central Asian and Transcaucasian states have primarily opted to address the latter problem, i.e. to upgrade transportation links in order to expand the competitiveness of domestic industries. In particular, the CIS countries have sought to improve their transportation links with countries outside the CIS, often with the support of multilateral and bilateral development agencies. For example, all Central Asian states have signed the TIR Convention, the most important international convention covering transit by road. Within the framework of the EEC and the ECO, several transit agreements have been negotiated. As often, however, the results of these agreements have been mixed.

Railways remain the main method of international transport in the CIS, but state monopolies have maintained inefficiencies and raised the costs of transport for private shippers. Also, large portions of the rail stock in Central Asia and Transcaucasia have been destroyed by war or cannibalised for foreign exchange (UNDP 2005). Lack of cooperation among the CIS countries regarding transport and transit issues have also dramatically increased transportation costs. Although the railway and road network is reasonably well-developed by the standards of developing countries, the railway and haulage fleet is outdated, and transport bottle-necks exist on some key routes. Furthermore, investment policy has not been coordinated among countries, leading to duplication of transport routes and inefficient operation of the transport system (EBRD 2003).

Actually, even if the southern-tier countries were able to construct a transportation highway to the European market along the lines of the EU-funded TRACECA (Transport Corridor Europe-Caucasus-Asia) Programme, the high cost of inter-modal transportation would

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[20] It should also be noted that two Georgian coastal regions, Abkhazia and Ajaria, with two major ports, Sukhumi and Batumi, respectively, have, with significant Russian financial, political, and military support, attempted to secede from Georgia. As of 2006, Abkhazia remains largely outside control of the central government in Tbilisi, thus effectively reducing Georgia's access to the Black Sea.

[21] In fact, it has been estimated that a 50 percent reduction in trade costs in Central Asia would increase GDP by 20 percent in Kazakhstan and 55 percent in the Kyrgyz Republic over 10 years (UNDP 2005).

still seriously lower the competitiveness of these countries.[22] This proves a critical point: the relevant measure of world market competitiveness in terms of transportation cost is not absolute distance but the cost and time of transportation. If a country or region is unable to lower transportations costs, it is effectively excluded from world market participation for a wide range of goods. In particular, the unfortunate combination of remoteness, landlockedness, deficient transport networks, low-quality transport services, and weak border management, customs administration and transit systems increases transportation costs immensely, particularly in the case of international shipments.

3.2 Economic Legacies of the Soviet Period

Adding to the geographical constraint on CIS development is a long history of economic backwardness. In contrast to other economically underdeveloped, geographically remote regions, the CIS is burdened by the legacies of the Soviet command economy, a few aspects of which were stressed in the previous section. Two features of this legacy require particular treatment.

First, the Soviet division of labour left the southern republics with industrial structures that were unprepared for world market forces by the time independence came. The maintenance of supply connections for industry and agriculture, the departure of many skilled Russians, the drying up of subsidies from Moscow, and the disappearance of the central administrative apparatus of the Soviet Union led to a dramatic economic collapse. Extractive goods and food commodities – products notoriously prone to international price fluctuations – dominated the Central Asian economies. The more industrialised parts of the Transcaucasian republics were focused on defence production, demand for which plummeted after the Soviet collapse (Bartlett 2001; Åslund 2002). The result was a huge drop in real GDP throughout the CIS. Most factories simply shut down, whereas others operated at sub-capacity levels with little prospects of returning to the output levels of the late 1980s. The GDP growth experienced in some countries after the mid-1990s came largely on the back of an expansion of services, agriculture, and rising world market oil prices. The much-needed conversion of production from defence and heavy industry production to light industry and consumer goods proved to be a more difficult task than predicted by reformers.

The former command economies of East and Central Europe also suffered dramatic drops in GDP during the first years of the 1990s, but they were able to recover more quickly because of their more diversified markets and their proximity to the EU. As a result, East and Central Europe was much better positioned to attract Western investment than the CIS. For example, by the end of 1998, the stock foreign direct investment (FDI) in Hungary, Poland, and the Czech Republic reached $53 billion, a significant portion of which was dedicated to advanced manufacturing. By contrast, the eight Transcaucasian and Central Asian countries attracted less than $12 billion, nearly 80 percent of which went towards the oil and gas industries of Azerbaijan and Kazakhstan (Bartlett 2001).

[22] The TRACECA Programme is a technical assistance programme to develop a west-east transport corridor from Europe, across the Black Sea, through Transcaucasia and the Caspian Sea basin to Central Asia. It was launched in May 1993 by the original eight TRACECA countries (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan). By 2005, the TRACECA Programme had financed 39 technical assistance projects totalling €57.7 million and 14 investment projects totalling €52.3 million. For a good overview of the status of transport infrastructure and international transport infrastructure projects in Central Asia, see UNDP (2005).

Second, Soviet rule left the CIS countries highly economically dependent on Russia. The Transcaucasian states have reduced their dependence on Russia somewhat by developing commercial relations with Western Europe and the large non-CIS developing countries neighbouring the region, such as Turkey and Iran (Olcott, Åslund, and Garnett 1999). Yet most CIS states, particularly the five Central Asian states, remain closely tied to the Russian economy, a factor that limits regional developmental prospects.

The transportation problems mentioned above are amplified by the fact that transit links remain geared towards the old trade patterns within the Soviet Union. The CIS countries inherited highly integrated transport networks, which were built with little regard for the administrative borders between the Soviet republics and were mostly oriented towards Russia, effectively making these countries dependent on Russia for transport to world markets. At the same time, transport infrastructure links with neighbouring countries such as Afghanistan, China, India, Pakistan, and Turkey were poorly developed (UNDP 2005). Russian authorities have used this economic leverage over neighbouring states to impose their geopolitical will even on countries that have succeeded in reducing their trade dependence on the regional superpower.

3.3 Political and Security Obstacles

The political gap between CIS and the East and Central European states is equally large as the economic one. The dissolution of the Soviet Union led to the establishment of political regimes that had great and understandable interest in preventing chaos and civil conflict. They acted quickly to establish a sense of identity among their ethnically diverse populations, create national symbols and institutions along with a clear sense of sovereignty, and protect the sanctity of new external borders.

Although these regimes managed to avoid cross-border violent conflict and, with the exception of Tajikistan, civil strife they also created a political structure in which they retained almost exclusive political power. Azerbaijan, Kazakhstan, Uzbekistan, and Belarus have developed into semi-authoritarian presidential systems with little or no opposition; Turkmenistan is best described as a dictatorship with a bizarre cult of personality around President Saparmurat Niyazov. According to international observers, there have been few free and fair elections in these countries since independence, and electoral fraud, press censorship, and harassment of opposition groups have been commonplace all across the CIS.

Figures from the 2005 Transparency International Corruption Perception Index 2005 indeed paint a gloomy picture: Armenia and Moldova are the highest ranking CIS countries at place 88 among least corrupt countries in the world, whereas all the Central Asian countries end up at the bottom of the list; Turkmenistan is third to last – tied with Myanmar and Haiti, and better only than Bangladesh and Chad (Transparency International 2005).

The advocates of "soft authoritarianism" argue that full-fledged democratisation would reignite ethnic violence and jeopardise the fragile cease-fires in Nagorno-Karabakh, South Ossetia, Transnistria, and Tajikistan. Uncontrolled democratic contestation would also frustrate state consolidation in countries like Uzbekistan that are struggling with Islamic fundamentalism and large-scale drug traffic (Bartlett 2001). Furthermore, the personal relationships between the authoritarian presidents in Central Asia, which rose together through the ranks of the Communist Party in the Soviet Union before becoming presidents in their newly-independent home countries, has served as one of the few impetuses to regional cooperation in that area.

At the same time, authoritarian leaders have aimed to strengthen their control over national territory and have been deeply reluctant to share any elements of sovereignty. In the 1990s, national elites sought to protect their assets by limiting any external competition and maximising the rents that could be extracted in the short term. The combination of political, institutional, and economic developments, particularly in the post-independence environment of economic decline, explains to a significant extent why regional cooperation in the early years after independence remained weak despite many political statements to the contrary (UNDP 2005).

Weak institutions and civil strife across the CIS has also opened up for cross-border military involvement. Russia has been the most prominent regional actor in the conflicts of the former Soviet republics. Acting independently or through the CIS, Russia has been involved in one way or another in every conflict of consequence (Brown 1996; Olcott, Åslund, and Garnett 1999). Undoubtedly, Russia has used the political instability generated by armed conflicts in its neighbouring countries to gain political advantages and establish military presence. Today, Russia has permanent military bases or "peacekeeping" units in several CIS countries, including Georgia, Armenia, Moldova, and Tajikistan, which all saw bloody conflicts in the 1990s.

When it comes to economic development, however, authoritarianism is not a particularly attractive instrument. It has been claimed that concentration of political authority in the presidency is necessary to circumvent opposition to economic reform in the post-Soviet legislatures, many of which are still dominated by nationalists and former communists. But while the accumulation of executive powers has given CIS presidents short-term political advantages over anti-market elements in national legislatures, it has frustrated establishment of the institutional conditions essential for long-term economic development (Bartlett 2001).

3.4 Political Economy

Lastly, the opaque workings of political economy in the CIS, and particularly in Russia, have also been pointed out as a serious impediment to integration and development. In the CIS, the high concentration of production output and exportables in a few sectors makes way for very influential industry lobby. A country that does not produce a specific product has no interest in its protection, while countries that do have protectionist ideas. For example, in Ukraine, the ferrous metallurgy contributes with 20 percent of the country's GDP and over 40 percent of exports. Furthermore, more than 500,000 workers are employed in the sector. Support for the metallurgical sector is extended not in terms of trade subsidies but in indirect (debt write-offs, controlled prices on intermediate goods) and as well as direct (reductions of obligations on enterprise profit and other taxes) subsidisation of national producers. Despite this choice of instrument, 43 antidumping investigations were initiated against Ukraine metal exports in 1993 to 2001. In Russia, higher import tariffs have been rewarded to industries with higher import penetration, higher employment, higher share of loss-making enterprises and higher share in total imports. The same holds true for the other CIS countries as well (Afontsev 2005). As a result, the movement towards intra-regional free flow of goods is further hampered.

Political economy in the CIS is thus partly manifested through restrictive import policies for goods which are produced domestically and also through other indirect measures targeted at improving the competitiveness of domestic producers. These results are, of course, also valid for many countries outside the post-Soviet space, but they become exceedingly pronounced in the CIS where the unweighted share of the three largest export products equals close to 70 percent (see Appendix 6).

Another kind of political economy factors has also played an important role in the CIS. In particular, there are present aspects of political economy, which have been advanced by Stopford and Strange (1991). They analyse conflict and cooperation between states and multinational corporations in competition for world market shares arising from the fact that 'the state needs the production for the world market to be located on its territory, no matter who is organising it, the firm needs the production for the world market under its ultimate control, no matter where it is located – and in many cases, no matter who possesses title or ownership' (Stopford and Strange 1991, pp. 211-212).

Although the findings of Stopford and Strange preceded the break-up of the Soviet Union, their results are highly relevant in the case of the CIS. The major difference from the theoretical framework of Stopford and Strange is, however, that many influential enterprises – which, with few exceptions, are active in the extraction and distribution of natural resources – in the CIS countries are controlled at least in part by governments, or, more accurately, the Russian federal government. For example, the Russian government owns 51 percent of the gas monopoly Gazprom, which produces 94 percent of the country's natural gas and controls an estimated 25 percent of the world's gas reserves (Hoover's Company Profiles 2006). The oil and gas pipeline monopoly Transneft is also controlled by the Russian government. Moreover, through Gazprom, the government also owns 73 percent of Sibneft, Russia's fifth largest oil company. Furthermore, a 53 percent share stake in the electricity monopoly Russian Joint Stock Company Unified Energy Systems of Russia (RAO-UESR) gives the Russian government control of a significant share of all electricity output in the country, but also in neighbouring CIS states.[23]

With oil production at 459 million tonnes or almost 12 percent of world output in 2004, Russia is also by far the largest oil and gas producer in the CIS (see Figures 3 and 4). In fact, Russia is the world's second largest producer after Saudi Arabia. Kazakhstan, Azerbaijan, and Turkmenistan have all increased their production over the last 15 years, and they are all huge net exporters.[24] Natural gas is also an important energy resource in the CIS with six producing countries; Russia is the world's largest gas producer with 22 percent of total output, closely followed by the USA (BP 2005).

Energy stands out as a major exception in the general move towards market principles in the CIS. This is especially true for trade in natural gas, the export of which is, of course, dominated by Gazprom. The main peculiarity of energy trade, particularly in natural gas, is not primarily the large oligopolistic or monopolistic production companies, but rather the far-reaching monopolisation because of the oil and gas pipelines and the power grid that constitute its transportation network. Most of these pipeline systems ended up in Russia's control after the break-up of the Soviet Union. Russia thus largely controls the ability of the Central Asian and Transcaucasian countries to export gas and oil through the old Soviet pipeline system, which gives it tremendous leverage in the political and economic relations with these countries.

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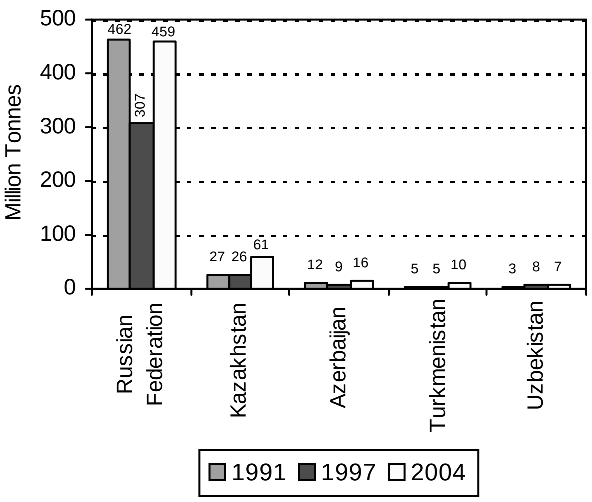
[23] Also, Gazprom owns 11.6 percent of RAO-UESR, effectively putting the federal government's ownership share of RAO-UESR at 64.28 percent as of 31 January 2006 (European Daily Electricity Markets 2006).

[24] Although the volume of output has only marginally increased or, in the case of Russia, actually slightly decreased since the early 1990s, the increase in terms of value is more impressive. The average spot price of Brent oil nearly doubled between 1991 and 2004 when measured in 1991 and 2004 USD, respectively, and rose by 37 percent in terms of 2004 USD (British Petroleum 2005).

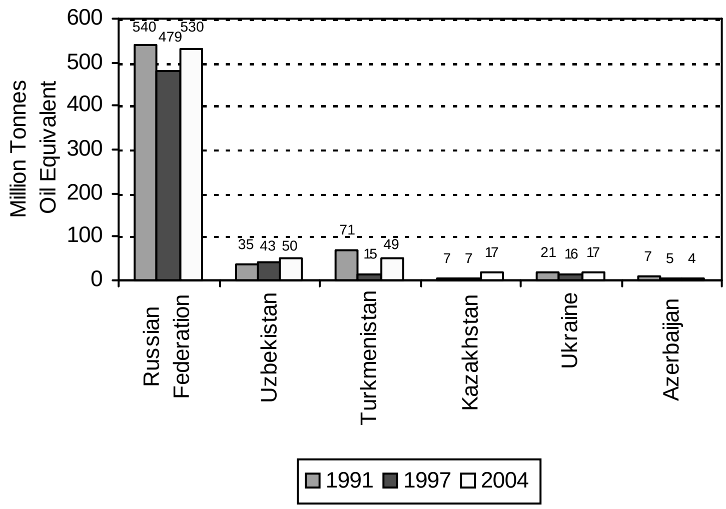
Russia has used its control of the pipeline system ruthlessly. Big energy companies have been allowed to profoundly influence Russia's energy policy, and until the end of 1997, Russia was the only country in the CIS to export gas outside of the CIS. Turkmenistan had no outlet for its gas exports, and Russia would only allow it to export to Ukraine, Georgia, and Armenia, which all had poor payment records. For over a year in 1997-1998, the Turkmenistan gas exports to Ukraine were stopped because of a dispute with Gazprom, causing Turkmenistan's exports to CIS countries to fall by 61 percent in 1997 and its GDP to drop by 26 percent (Olcott, Åslund, and Garnett 1999). Russia has allowed Kazakhstan restricted access to the Russian oil pipelines. The official explanations have been limited capacity of the pipelines and the fact that the Kazakhstan oil is claimed to be so sulphurous it would downgrade the pipelines. In early 1999, Russia reversed its position and allowed for more exports through its pipeline system. This could be explained by Kazakhstan's increasing interest in constructing a pipeline across the Caspian Sea, which would allow Kazakhstan to connect to the Baku-Tbilisi-Ceyhan pipeline and effectively break the Russian pipeline monopoly.[25]

Figure 2. Oil Production in the CIS



Source: BP (2005)

Figure 3. Gas Production in the CIS



Source: BP (2005)

Russia is also using its pipeline monopoly for price discrimination, which has been especially prevalent in natural gas exports. Gazprom has been keen to enter barter agreements for its gas deliveries, not only because it allows the company to avoid paying taxes, but also precisely because it enables price discrimination (Olcott, Åslund, and Garnett 1999). In some cases barter agreements even seem logical as a means of payment; Gazprom in part supplies Ukraine, Belarus, and Moldova with gas in exchange for transporting it through pipelines on their territories to European markets. Gazprom has also developed a strategy of debt-equity swaps by which it makes claims on the pipeline systems of other CIS countries in exchange for annulling accumulated gas delivery debts. Belarus, Moldova, and Georgia have given up much of the ownership of their domestic pipeline systems to Gazprom as a consequence of this strategy.

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[25] Baku is the capital of Azerbaijan, located on the Caspian Sea coast; Tbilisi is the capital of Georgia, and Ceyhan lies on the Turkish Mediterranean coast.

Countries that have agreed to closer political relations with Russia have received gas at lower prices. The Baltic states were thus subject to a price increase to world market prices when they decided to leave the Ruble Zone in 1992. Georgia, too, was initially denied the subsidised Russian gas prices, because it refused to join the CIS. Belarus is at the time of writing the only CIS state that buys natural gas from Russia at the record low price of $45 per 1,000 cubic meters. The price for Ukraine, for example, has been raised to $95 after the energy crisis in January 2006, with the world market price standing at around $230 (ITAR TASS 2006).

Although Russia has been the leading actor in the "pipeline politics" of the FSU, other countries have used energy supplies to exert political and economic concessions as well. This is particularly true for the countries in Central Asia, where Kazakhstan, Uzbekistan, and Turkmenistan are net energy exporters, whereas the Kyrgyz Republic and Tajikistan have no fossil fuel reserves. The former countries have not hesitated to link supply of energy to political conflicts.

In Transcaucasia, Azerbaijan is the only oil and gas producer. Armenia is dependent on imports of fuel and electricity from neighbouring countries. Because of the unresolved conflict in Nagorno-Karabakh, the country cannot import fuel from its oil-rich neighbour Azerbaijan. Instead, it imports oil and gas from Russia via pipelines through Georgia. Some fuel is also imported from Iran, and there are plans to build oil and gas pipelines to Armenia from that country. Georgia is also dependent on other republics for energy. Turkmenistan, its major supplier of natural gas, has periodically cut off deliveries due to payment failures (Gregory and Stuart 2001).[26]

Also, issues of water usage have stirred political confrontations in Central Asia. The Kyrgyz Republic and Tajikistan, the upstream countries along the two main rivers of the region – the Amu Darya and the Syr Darya – prefer to maximise the water for generating electricity, especially in the winter. The downstream countries, Kazakhstan, Uzbekistan, and Turkmenistan, prefer to have maximum access to water for irrigation during the summer months, while also avoiding the floods caused by water releases during winter time. At a 1994 meeting in Uzbekistan, Central Asian leaders established an interstate body to regulate the use of water resources. Other organisations have also been proposed to deal with water management issues. In reality, however, states in the region have tended to deal with water usage issues through a series of bilateral and trilateral agreements, all of which have been marred by problems. These agreements often amount to little more than controlled barter. In 1997, for example, the Kyrgyz Republic agreed to deliver water to neighbouring Kazakhstan and Uzbekistan in return for coal from the former and gas from the latter (Ilkhamov 2002). This agreement has resulted in several conflicts and threats of discontinued supplies. According to some estimates, the Central Asian region loses $1.7 billion per year, equivalent to three percent of total GDP, from poor water management that lowers agricultural yield. Along the same lines, the annual benefits to Central Asia from cooperation in water sharing and conservation amount to about five percent of GDP (UNDP 2005).

[26] The author experienced the problems with electricity shortages in Georgia during a trip through Transcaucasia in April 2000. The train that was supposed to go to Yerevan from Georgia's capital Tbilisi could not leave the central station because there was a demonstration against the electricity shortages on the tracks at the next station. This experience also included a case study of Caucasian *shuttle trade* as a woman in the same compartment had filled every available luggage space with boxes of breakfast cereals, which she would sell in Armenia at a small profit. However, after spending six hours in the train at the central station, the author and his travel companion left the train as darkness fell over the Georgian capital and the blacked-out train compartment.

4 THE THEORY OF ECONOMIC INTEGRATION

In the previous section, I demonstrated that the main obstacles to regional economic cooperation and integration in the CIS are geographical constraints; economic legacies of the Soviet period; political and security issues; and political economy. Below, I will examine the development strategies that have been proposed to mitigate these issues. Judging by the empirical evidence produced hitherto, you could, however, be forgiven for thinking that no such strategy exists. The CIS countries remain bogged down in bitter political and economic conflict, and there seems to be little hope that they will ever overcome their differences. Integration on a regional or global level remains utterly elusive for several CIS countries. Even the smallest steps towards economic cooperation have not, with few exceptions, resulted in any real success.

The development strategies attempted so far in the CIS have, as a consequence, been mostly unilateral, and they have not created the prerequisites for further growth and democratic development. Indeed, few economists would advance strategies such as resource-based development for a region with corrupt and poorly developed democratic governmental practices. Nevertheless, it seems to have become the unfortunate strategy of choice for several oil- and gas-rich CIS countries. Furthermore, although import-substitution industrialisation was consigned to the scrap heap of unsuccessful development strategies several decades ago, it has not prevented Uzbekistan from pursuing precisely that objective. Apart from creating massive trade diversion by raising trade barriers and nursing inefficient industries, this strategy effectively blocks regional integration as an alternative means of development over a long period of time.

The development strategy for the CIS that has been proposed by international economists as the "first-best" solution is full-scale market and price liberalisation coupled with multilateral integration. In the late 1980s, this economic school, known as the Washington Consensus, emerged as the dominant development model. The central goal of the liberalisation programme is to expose national economies to the discipline of world market forces, prepare domestic enterprises for local competition, and induce multinational corporations to integrate local subsidiaries into transnational production networks (Bartlett 2001). By the early 1990s, large parts of Latin America as well as East and Central Europe had embraced the ideas of market liberalisation and multilateral economic integration, whereas the CIS countries continued to establish various regional trade blocs.[27] Despite the further development of economic theory, economists remain far from united on the welfare implications of regional trade blocs. Nonetheless, trade liberalisation and multilateral integration have remained key components of the post-Washington Consensus agenda, which continues to advanced neoliberalism as the "first-best" strategy in developing countries.[28] In this section I will look at the components, which build the theoretical argument in favour of multilateralism as opposed to economic integration in the form of regional trade blocs.

[27] Poland, the Czech Republic, the Slovak Republic, Romania, and Hungary became WTO members on 1 January 1995. Bulgaria was accepted into the organisation one year later. The CIS countries' relations to the WTO are described in detail in section 4.4.

[28] While the original Washington Consensus made economic growth the main goal of development, the post-Washington Consensus, according to its supporters, moves away from the neoliberal, market-friendly approach and places sustainable, egalitarian and democratic development at the centre of the agenda. Critics claim, however, that the original neoliberal agenda still underpins the post-Washington Consensus, arguing that the social safety net aspects of the new policies are put in place as an add-on to deal with market failure.

The contemporary debate on trade blocs can be traced back to World War II and the immediate post-war period. In 1950, Jacob Viner published his path-breaking book *The Customs Union Issue*, outlining the theoretical foundation of trade blocs. US foreign economic policy-makers of this period firmly believed that regional trade blocs in combination with international trade liberalisation would eventually lead to the adoption of a world-wide multilateral trade regime. For this reason, regional trade blocs would, sooner or later, be consigned to economic history. Historical developments seemed to confirm these predictions until the economic slowdown of the 1970s. Contrary to these political convictions and theoretical considerations, the history of the European Union, and more recently the formation of NAFTA, ASEAN, and Mercosur, confirms the enduring nature of regional trade blocs (Kennedy 1996).

4.1 Levels of economic integration

In his 1962 book *The Theory of Economic Integration*, Bela Balassa provided the first clear division of the levels of economic integration; free-trade area, customs union, common market, economic union, and complete economic integration.[29] A free trade area is regarded as the lowest level of economic integration and, naturally, complete economic integration as the most advanced level of integration.[30] In a *free-trade area* tariffs and quantitative restrictions on all trade between the participating countries are abolished, but each country retains its own tariffs against nonmembers. A *customs union* involves the removal of discrimination in the field of commodity movements within the union and the equalisation of tariffs in trade with nonmember countries. A higher level of economic integration is achieved in a *common market*, where not only commodity trade is unrestricted but also restrictions on factor movements (labour and capital) are removed. An *economic union*, as distinct from a common market, combines the suppression of restrictions on commodity trade and factor movement with some level of harmonisation of national economic policy. Finally, *full economic integration* presupposes the unification of monetary, fiscal, social, and countercyclical policies and requires the establishment of supra-natural authority whose decision are binding for the member countries.

In this study, FTAs[31] and customs unions comprise the most important forms of integration, since these, perhaps with the exception of the Russia-Belarus currency union, are the levels of economic cooperation that have been seriously attempted in the CIS countries. Consequently, in the following I shall focus on the theory that provides the arguments in favour and in opposition to these lower levels of economic integration.

[29] FTAs, customs unions, and common markets are often – including in this thesis – collectively referred to as *trade blocs*.

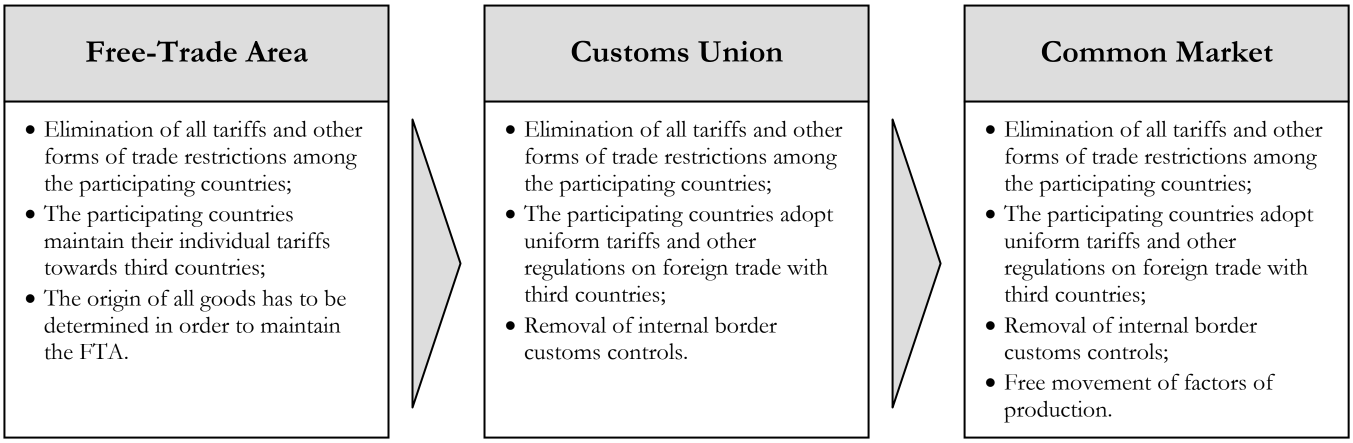
[30] *Preferential trading agreements*, which are often concluded on a bilateral basis, could also be argued to represent a level of economic integration, but since they lack consistent theoretical underpinning and come in an infinite number of shapes and forms, they will not be discussed as a part of this section.

[31] The acronym "FTA" is short for both Free Trade Area and Free Trade Agreement, which might initially confuse the reader. The distinction between these two concepts, however, simply lies in the fact that a free trade area comprises the territories of the signatory states of a free trade agreement. The expression "the countries of an FTA", then, might imply one of two things, but the actual difference between the two is seemingly irrelevant.

4.2 The Theory of Customs Unions

Balassa begins the analysis of the impacts of a customs union on resource allocation with reference to a hypothetical free-trade situation.[32] In such a situation of free trade, the price of individual commodities can vary only by the amount of transportation cost, and any given commodity is produced at the cheapest source of supply. The introduction of tariffs in a country will now have two main effects. First, the production of some commodities will shift from lower-cost foreign producers to protected higher-cost domestic producers. Second, consumer demand will shift from foreign goods to domestic products in response to the change in relative prices following the introduction of tariff. Both these changes will reduce world welfare.

Figure 4. Lower Levels of Economic Integration



In an FTA, as distinct from a customs union, the abolition of tariffs between the member countries is not accompanied by the establishment of uniform tariffs on the imports of goods from third countries. As a consequence, these two forms of economic integration will have identical effects on world welfare only if all countries of the free-trade area have the same tariffs prior to integration. In examining the economic effects of the removal of intra-area trade restrictions below, identical initial tariffs will be assumed for each country. By reason of this assumption, the analysis will apply to both customs unions and free-trade areas, and the expression "customs union" or "union" will refer to both. Later in this section, I will analyse the consequences of disparate tariff levels in a free-trade area in relation to third countries.

Through the establishment of a customs union, tariffs on all goods produced in participating countries will be abolished, thus effectively ceasing the discrimination between domestically produced goods and goods produced in partner countries. At the same time, however, it gives rise to discrimination between commodities produced in partner and in third countries. Whether the net effect of the union's establishment represents a move towards freer trade or increased discrimination depends on the relative magnitudes of various factors, namely *production effects*, *consumption effects*, *terms-of-trade effects*, and *administrative economies*. Each of these will be discussed in turn.

[32] This section builds on Chapter 2 – 4 in Balassa (1962).

Production Effects of Economic Integration

Viner (1950) introduced the concept of *trade-diverting* and *trade-creating* effects of economic integration. The former concept refers to newly created trade between the member countries of the union, whereas the latter refers to trade diverted from a foreign country to a member country, both resulting from the elimination of tariffs within the union.

Under the assumption of perfect competition, constant costs, and zero transportation costs, the world market price of any commodity, as argued above, will be equal to the production cost in the lowest-cost country. It follows from this, that countries where the production costs are higher than the sum of the world market price and the relevant tariff will import that commodity from the lowest-cost source. Other countries will, with analogous reasoning, produce the commodity domestically. Assume now that a customs union is formed between countries A and B which excludes country C. Depending on where the lowest-cost production of a given commodity takes place and where the initial production took place, the trade-creating and trade-diverting effects will vary.

Trade creation, then, represents a movement towards the free-trade position, since it brings about a shift from high-cost to low-cost sources of supply, while trade-diversion – a shift of purchases from lower-cost to higher-cost producers – acts in the opposite direction. Viner points out, however, that all the effects in a particular case will not necessarily point in the same direction, but rather that the net effect may be either trade-creating or trade-diverting.

Consumption Effects of Economic Integration

Tariffs create inter-country differences between the price rations of traded commodities. Consequently, removing the tariffs will improve the efficiency in exchange through the equalisation of these ratios. Balassa (1962, p. 58) reaches the conclusion that '[s]ince the effects of a customs union on world efficiency depend on the ensuing changes in the pattern of production and consumption, world real income can increase even in the absence of any improvement in productive efficiency, provided that efficiency in exchange increases'. Extending this argument makes it evident that the larger the amount of trade conducted with partner countries in comparison to trade with third countries, the more likely it is that consumption effects will be positive; and the lower the volume of pre-union foreign trade conducted by the prospective customs union members, the smaller will be the possibility of negative consumption effects. Naturally, the consumption effects of a union also depend on the relative difference between the tariff rates applied to trade between the participating countries prior to the customs union and the tariffs levied on imports from nonparticipating countries.

Terms-of-trade Effects

The changes in the pattern of trade following the removal of intra-union tariffs will also affect the net commodity terms of trade, defined as the ratio of exports and import prices. The trade-diverting effects of a customs union can be characterised as a shift in the union members' reciprocal demand for foreign goods. This shift will improve the union's terms of trade, and, other thing being equal, a greater shift in reciprocal demand will bring about a larger improvement in the terms of trade. In addition to this, changes in the terms of trade will also depend on the elasticity of reciprocal demand.[33] For example, in the early 1990s, many FSU countries were hit by adverse terms-of-trade effects when the demand for their domestically produced goods plummeted in the aftermath of the break-up of the Soviet production system. At the same time, the former Soviet republics had to begin importing goods at unsubsidised world market prices, further reinforcing the negative terms-of-trade effects.

Administrative Economies

The removal of tariffs between the members of a customs union leads to administrative economies in the form of cost saving in the state fiscal apparatus.[34] Moreover, intra-union trading companies will be able to significantly reduce administration, since they will no longer have to comply with customs formalities and adapt to complex tariff laws. In addition to procedural obstacles and consequent costs encountered by importers in general, administrative regulations on imports often provide indirect protection to special groups of domestic producers. Classification of commodities for tariff purposes, procedures for assessing and collecting customs duties, rules of sanitation, preservation of health, maintenance of standards, protection of copyright, patents, trade marks are examples of such obstacles.

While the abolition of tariffs will result in cost savings for governments and traders alike, the additional burden of negotiation, coordination of codes, mutual supervision, and tax problems will work in the opposite direction.

Particular Problems of a Free-trade Area

So far, I have discussed customs unions and free-trade areas under the assumption that the members of the FTA impose identical tariffs on all commodity imports from third countries, thus effectively creating the same trade diversion and trade creation in the free-trade area that would have been the case in a customs union with the same participating countries. However, this scenario is unlikely in the real world, where disparate tariffs on the same commodity in the countries of an FTA are likely to prevail, since the main rationale for creating an FTA (rather than a customs union) is that the participating countries are able to maintain their individual tariffs and determine their own trade policies.[35] The maintenance of differing rates of duties in trade with nonparticipating countries in an FTA will create possibilities for deflection of trade and production, which, in turn, give rise to significant administrative problems.

Unlike a customs union, the determination of a product's origin is important in an FTA, because if no precautionary measures were taken and tariff differentials outweigh the transportation costs, imports of a particular commodity would enter the FTA via the country

[33] The elasticity of reciprocal demand is determined by the elasticities of supply and demand of the traded commodities. If a union is so small that it cannot influence world market prices, the elasticity of demand for its imports and the elasticity of supply for its imports can be regarded as infinite. Consequently, the formation of such a small union would not effect the terms of trade. An increase in the size of the union will, according to Balassa (1962), have the tendency to improve its terms of trade.

[34] It is, however, important to note that the benefits of reduced administration will be reaped only in a customs union as opposed to an FTA, where the participating countries levy different tariffs on the same commodity. In the case of an FTA, Balassa argues that the cost of administration is likely to increase rather than decrease.

[35] According to the definition in GATT (1947, art. XXIV, sec. 8b), 'A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce … are eliminated on substantially all the trade between the constituent territories in products originating in such territories.'

which applies the lowest tariff of that commodity.[36] According to the CIS rules of origin, which were established in 2000, a product is considered to be of CIS origin if it is fully produced in the CIS country or, when imports are used in its production, if the designation of the product is different from the designation of the inputs according to the 4-digit CIS trade nomenclature. This is the default principle, but a long list of goods is exempted from this rule (Freinkman et al 2004).[37]

Balassa concludes that in an FTA, any procedure used to avoid deflections in trade and production will require considerable administration. In fact, it can be expected that the increased costs of administration can outweigh the cost saving in the fiscal apparatus that comes as a result from removing intra-area tariff barriers. In the words of Bhagwati, Greenaway, and Panagariya (1998, p. 1139): 'All of these [specification and computation] problems, which inherently lead to absurd arbitrariness in trying to identify the origin of products, are seriously presented when an FTA inevitably requires that the origin be established for virtually all traded products.' Thus, other things being equal, an FTA will lead to a less efficient resource allocation than a customs union. Unproductive expenditures will also be higher.[38]

4.3 Dynamic Efficiency

The discussion above on the welfare consequences of economic integration has solely involved so called *static* factors. We have regarded as equal an increase in potential welfare and an improvement in the allocation of resources at a point in time. Such static efficiency, however, is only one of the possible success criteria that can be used to estimate the effects of economic integration. Balassa argues that greater attention should be paid to dynamic efficiency, defined as the hypothetical growth rate of national income achievable with given savings ratio and use of labour and material resources.[39] Given a certain level of static efficiency of an economy, the factors affecting its dynamic efficiency are the presence of, for example, economies of scale, market structures, technological progress, and reduced risk and uncertainty.

Gains from *economies of scale* will be obtained in certain industries as a result of the wider market of a trade bloc. This presupposes, however, that the market in which the plant operated prior to economic integration was too small to permit the exploitation of economies internal to the firm. In North America, for example, further economic integration is unlikely to create much scope for additional economies of scale in many US industries, whereas in autarkic small countries with a

[36] This situation is often referred to as the "certificate of origin problem" (Bliss 1994, p. 8).

[37] Interestingly enough, the CIS rules of origin also stipulates that exports subject to free trade treatment must be conducted by tax residents in the FTA. This implies that the export of foreign-owned companies can be denied free-trade treatment if these companies or their subsidiaries are not registered in the relevant FTA (Freinkman et al 2004).

[38] This view is, however, contested by other economist. Schiff (2000), for example, claims that customs unions require a greater degree of compromise than FTAs and thus are more costly. In his view, customs unions entail the creation of public goods, whether it is common trade policy, security, governance, or some other aspect of deep integration, while this is much less the case with FTAs. Schiff finds that the ratio of FTAs to customs unions around the world averaged 1.3 in the first four decades following World War II, and then climbed to 9.5 in the 1990s.

[39] Balassa also offers us a more technical definition of dynamic efficiency: 'whereas static efficiency would require that the economy operate on its production-possibility frontier, dynamic efficiency can be represented by the movement of this frontier in the northeast direction' (Balassa 1962, p. 13). It is important to note that output growth cannot be equated to welfare growth, as some of the mechanisms that may result in an increase in the rate of growth of output in a future period may involve reduced consumption and welfare in the short term (Michalopoulos and Tarr 2004).

small domestic market, of which there are several in the CIS, there should be substantial potential for economies of scale in a customs union.

Economic integration affects the *market structure* of the member states inasmuch as the competition between producers is likely to increase. More specifically, in industries where only one or a few firms operate within a country, the removal of tariffs increases the number of potential competitors, and thereby weakens monopolistic and oligopolistic structures. In sectors characterised by national monopolies, oligopoly will become the dominant market structure, while in oligopolistic industries the group of competitors will increase further. Consequently, the market power of national monopolies is bound to decline and the broadening of oligopolistic tendencies structures is likely to reduce the possibilities of oligopolistic coordination and collusion.

At the same time, an increase in the average size of the firm may increase the pace of *technological progress*, since large-scale economies in research can be obtained on both the national economy level and the firm level. Access to a diverse mix of products including modern technology appears to be very important for the growth process. New and diverse technology is appearing constantly, and these new technologies allow an increase in the productivity of both labour and capital (Michalopoulos and Tarr 2004).

Moreover, economic integration will reduce *risk and uncertainty* in the economic relationships of customs union members. In the absence of a customs union, a number of factors contribute to the risk profile of foreign transactions; complexity of trade regulations, the possibility of unilateral changes in tariffs and other forms of trade restrictions, foreign-exchange regulations, and economic policies in general are a few of them.

In conclusion, dynamic efficiency is an important aspect to take into consideration when evaluating the likely outcome of an economic integration project. Although static efficiency provides a more intuitive explanation of the advantages and potential problems of economic integration, dynamic factors are bound to significantly affect welfare in trade bloc member states, particularly in the long run.

4.4 Regional versus Multilateral Economic Integration

From the point of view of prevailing economic theory, it is clear that regional integration can never be Pareto superior to multilateral integration, because lowering trade barriers vis-à-vis many countries will always create more trade than if trade is opened up only for a few countries. Every trade facilitating measure executed on a regional level would theoretically be even more efficient on a global level. In trade literature, multilateral economic integration is usually the same as WTO participation.[40]

Russia, along with Azerbaijan, Belarus, Kazakhstan, Tajikistan, Ukraine, and Uzbekistan are among the 30 countries attempting to accede to the WTO. Accession to the WTO has a major impact on a wide range of policies and institutions, including tariff policy, customs administration, standards, foreign investor rights, agricultural policy, and intellectual policy (Tarr and Barba Navaretti 2005). Other CIS countries – Armenia, Georgia, Moldova, the Kyrgyz Republic and the

[40] The WTO was officially known as the General Agreement on Tariffs and Trade (GATT) until 1 January 1995. The original GATT was signed in 1947 and is still in force, although a number of additional annexes and other documents have been added to the legal texts of the WTO. In 2003, trade among the WTO member states represented 97 percent of the world's trade turnover (Tarr and Barba Navaretti 2005).

Baltic states – have already gained membership in the WTO.[41] Indeed, Turkmenistan is the only FSU country that has not applied for WTO membership. The fact that certain CIS countries are members of the WTO, whereas others, Russia in particular, are nonmembers is not uncomplicated. At first sight, the principle of preferential treatment for member states in regional trade blocs runs counter to the notion of non-discrimination, which is the key element of the WTO. This fundamental incompatibility in principle has, however, done little to dampen the enthusiasm of policy-makers for regional trade blocs (Kennedy 1996). In fact, one of the major considerations that influenced the GATT architects was the wish to legislate against the world arranging itself into restrictive trading blocks built around countries and their ex-colonies (Bliss 1994).

Generally, the phraseology of the WTO's goals is not materially different from that of many regional trading blocs: the objectives of the WTO are income growth, ensuring full employment, developing full use of resources, and increasing the production and exchange of goods. These intentions are to be materialised through the provision of a secure and predictable international trading environment for the business community and a continuing process of trade liberalisation based on non-discrimination. The requirement of non-discrimination is embodied in the Most Favoured Nation (MFN) clause, according to which all contracting parties are obliged to grant to each other treatment as favourable as they give any country in the application and administration of import and export duties and charges (Sampson 1996).

Preferential trading agreements, then, are by definition violations of the fundamental non-discrimination principle, since the member countries in such agreements remove or reduce barriers against imports from each other, but not to third countries. Many economists have recognised the potential danger that regional trade agreements pose to the liberalisation of international free trade; for example, Sampson (1996, p. 14) argues that 'a proliferation of preferential trading agreements provide a major threat to the operation and even survival of the GATT trading system based on non-discrimination'. At the same time, it is important to bear in mind that the WTO does not prohibit tariffs, it merely regulates their application, and that the tariff-centred MFN rule may partly explain why other kinds of trade restrictions have been preferred to tariffs (Bliss 1994).

The WTO does indeed permit discrimination through the granting of regional preferences as an exception to the general rule of MFN treatment,[42] given that they obey a specific set of rules. These rules are aimed at preventing increased regional integration in a group of countries from being accompanied by increased protection against third countries. Indeed, the GATT states that '…the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories' (GATT 1947, art. XXIV, sec. 4). Similarly, the rules permit countries to form economic groupings to take advantage of their economies of scale that come from larger production units and thereby compete more effectively in world commerce. From this point of view, regional integration should, in principle, complement the multilateral trading system rather than threaten it (Sampson 1996).

[41] Armenia, Georgia, Moldova, and the Kyrgyz Republic gained membership of the WTO in 2003, 2001, 2000, and 1998, respectively. The Baltic states of Estonia, Latvia, and Lithuania became members in 1999, 1999, and 2001, respectively. Kazakhstan's application is fairly well advanced, and the country is expected to accede to the WTO soon, possibly during 2006 (UNDP 2005). Ukraine has also come far in its WTO negotiations.

[42] To ensure a certain level of transparency, the establishment of regional trade agreements has to be notified promptly to the WTO for examination by member countries, which may make recommendations.

5 FINDING A WORKABLE DEVELOPMENT STRATEGY

After having looked at economic integration theory, it can be concluded that trade blocs are established in order to increase welfare. In that sense, regional integration can be regarded as a *development strategy*, i.e. as a means by which trade bloc member states aim to achieve a higher standard of living. To be sure, there are no guarantees that trade blocs will indeed result in raised welfare – neither in the participating countries nor in the world at large – but it has to be assumed that the contracting parties of a trade bloc at least hope that this will be the case. Estimating the net static effect of trade diversion and trade creation over time, however, is bound to be a cumbersome task; determining the dynamic effects of a trade bloc is simply impossible. Nonetheless, judging by the mushrooming number of trade blocs across the world there appears to be a preconceived notion that trade blocs can indeed be welfare enhancing under certain circumstances, if not on a global scale then at least in the participating economies.

According to prevailing economic theory, however, multilateral economic integration is always superior to regional economic integration; it is the "first-best" development strategy. Opening up a country's economy for trade with many countries must create more trade than if it is opened to only a few neighbouring states. But is multilateral economic integration, as outlined above in the theory section, really the best strategy for the CIS countries under current economic and political circumstances?

Table 3. Selected macroeconomic indicators

	Population 2004 (mn)	2004 GDP (PPP, curr. int. $bn)	2004 GDP per capita (PPP, curr. int. $)	Cumulative average annual GDP growth 1992-2004	1999-2004
Armenia	3.0	12.9	4,222	5.0%	13.8%
Azerbaijan	8.3	34.6	4,175	7.7%	13.9%
Belarus	9.8	67.9	6,906	4.4%	9.3%
Georgia	4.5	13.5	2,977	4.5%	10.9%
Kazakhstan	15.0	112.1	7,494	4.9%	13.9%
Kyrgyz Republic	5.1	9.8	1,928	1.4%	5.7%
Moldova	4.2	7.3	1,742	-0.9%	6.6%
Russia	142.8	1,408.6	9,863	2.8%	9.2%
Tajikistan	6.4	7.7	1,193	-0.4%	10.4%
Turkmenistan	4.9	34.6	7,021	4.3%	19.4%
Ukraine	48.0	303.3	6,317	0.1%	11.0%
Uzbekistan	25.9	48.5	1,871	2.8%	5.5%

Sources: World Development Indicators Database

In the late 1990s some parts of the CIS began to introduce elements of the multilateral and market liberalisation agenda; the Kyrgyz Republic, Armenia, and Moldova – geographically isolated and with small domestic markets – opted for a multilateral approach to integration and successfully gained memberships in the WTO. The Bretton Woods institutions have advocated precisely this: integration of the CIS countries into the global economy through the WTO. At the same time, they have been highly critical of the formation of regional trade blocs within the CIS because it entails detrimental trade effects. For example, Åslund (2003) claims that Russia, Kazakhstan, and Ukraine – the three largest economies in the CIS – should strive for quick WTO accession instead of building regional trade blocs, because '[n]one of them can afford to fool around with economic nonsense in their trade policy'. The few cases where regional trade blocs have prompted trade creation involved large, developed countries whose markets possessed both the scale needed to spur regional industrial agglomeration and the scope required to stimulate intra-industry trade in differentiated products (Bartlett 2001). In developing countries, trade blocs have tended to become little more than instruments of import substitution elevated to the regional level.

The case for regional trade blocs in the CIS is thus difficult. In a seminar paper from 2005, World Bank economists Constantine Michalopoulos and David Tarr show that the dynamic effects of the EEC and the CIS free-trade area are likely to be negative, because it would tend to lock the countries into the old technology of the Soviet Union.[43] This is due to the fact that a large part of the worn out capital stock in the CIS has not been replaced since the break-up of the Soviet Union. Moreover, they conclude that the static effects are mixed but likely adverse for countries with liberal trade regimes compared to the common external tariff proposed for the EEC. Although Tarr and Michalopoulos deal specifically with the EEC, their results are easily applicable to any CIS trading bloc – of which Russia is a participating party – which involves the introduction of a common external tariff.

Although the analysis of Michalopoulos and Tarr is rigorous and theoretically well developed, I believe that it fails to identify the weaknesses of a multilateral agenda in the CIS context. While individual components of the neoliberal programme make sense for certain small economies in Central Asia and Transcaucasia, it is difficult to imagine a complete liberalisation strategy like the one in Latin America or East and Central Europe succeeding there or anywhere else in the CIS. Argentina, Brazil, and Chile's coastal positions and Mexico's proximity to the USA have greatly facilitated those countries' economic openings, and the former socialist states in East and Central Europe benefited immensely from their adjacency to the EU before becoming members themselves.

Table 4. GDP and trade growth since WTO accession

	Year of WTO accession	Average annual GDP growth since accession†	Unweighted average annual CIS GDP growth over period	GDP growth rank‡	Annual trade growth since accession†	Unweighted average annual CIS trade growth over period	Trade growth rank‡
Armenia	2003	15.0%	12.8%	5	3.9%	33.8%	12
Georgia	2001	13.0%	11.8%	5	47.9%	30.0%	2
Kyrgyz Republic	1998	5.7%	10.8%	11	13.9%	18.0%	10
Moldova	2001	8.6%	11.8%	11	28.1%	30.0%	7

† Counted from the first full year after WTO accession except for Armenia, where accession year is used as first full year.

‡ Where 1 is the CIS country with the highest growth rate and 12 is the one with the lowest growth rate.

Sources: World Development Indicators Database; IMF Direction of Trade Statistics

Even a full embrace of liberal trade policies would, however, not neutralise the shipping cost penalties emerging from the Caspian region's geography. The same holds true for large parts of central Russia as well. Thus, it is hardly surprising that multilateral trade agendas have not provided

[43] An earlier version of this seminar paper was published in 1997 as a World Bank Policy Research Paper (see Michalopoulos and Tarr 1997).

Recall that the EEC was originally known as the Customs Union when it was founded in 1995 by Belarus, Kazakhstan, and Russia. It later came to include the Kyrgyz Republic, and Tajikistan. In 2001, the EEC was established with the same members as the Customs Union, and in January 2006 Uzbekistan became the sixth member. Note that the Customs Union (written with initial capital letters) refers the EEC predecessor in order to separate it from the theoretical concept of a customs union, which, correspondingly, is written with initial lowercase letters.

immediate results in the CIS; for example, Armenia, Georgia, the Kyrgyz Republic and Moldova are all WTO members but, as shown in *Table 1*, more than a quarter of their trade is still conducted with other CIS countries, and almost half of this trade is with Russia (see Appendix 4). Furthermore, the official growth numbers of the Kyrgyz Republic are not particularly convincing: the economy in the Kyrgyz Republic, as shown in *Table 4*, has grown by 5.7% per year since it entered the WTO in 1998, putting it ahead only of Uzbekistan among all CIS countries. The numbers for Moldova and particularly for Armenia and Georgia are more impressive, but one must be extremely cautious in the interpretation of these numbers as the studied time period is short and the price of oil has been extremely high, which has boosted growth in the energy-rich CIS countries. Moreover, the reliability of the statistics in the case of certain countries such as Uzbekistan, Tajikistan, and Turkmenistan is highly questionable.[44]

5.1 The Case for Regionalism in the CIS

Although I have dismissed an exclusively multilateral trade agenda as an unrealistic development strategy for the CIS under current circumstances, the case for regionalism in the CIS is still, as the reader now realises, not straight-forward. The reason for this is quite simply that it is not a "first-best" strategy from a strictly theoretical point of view. Kennedy (1996) and EBRD (2003) admit that deepened regional economic cooperation could potentially serve as a catalyst for global integration, but they are careful to emphasise the possible hazards of regional integration developing into protectionism on a regional level. Åslund (2003) claims simply that the trade situation within the CIS will not improve until Russia, Kazakhstan, and Ukraine join the WTO. Indeed, few social scientists outside of the CIS view the development of regional trade blocs as a step in the direction of freer trade; Bartlett (2001), however, is carefully optimistic about the impact of an FTA in the CIS region, and he also supports the idea of a regional integration as a means to reach integration with the global economy.

I believe that multilateralism in the CIS through the WTO indeed has to be a key aspect of the CIS countries' development agenda, but it will not *per se* integrate these states in the world economy. Rather, multilateralism needs to function as an *integral complement* to regional integration, i.e. regionalism and WTO membership must together serve as vehicle for real integration with the world economy. My case in favour of a regional economic strategy in the CIS rests on five main arguments.

Multilateralism will Not Solve the Basic Problem

As I have shown above, several CIS countries have no serious prospects of integrating in the global economy in the foreseeable future. Even if they fully embrace the non-discriminatory principles and become members of the WTO, they will not be able to overcome their current geographical and economic predicaments. The "first-best" solution, entailing a strictly multilateral trade strategy is simply not achievable because of the overwhelming transportation costs. As long as CIS manufacturers are unable to compete with their products in the global marketplace, lowered import tariffs and a WTO membership – contrary to the opinion of, for example, Michalopoulos and Tarr (2005) and Åslund (2003) – will do little to increase growth and productivity. While multilateralism

[44] Note that IMF Direction of Trade Statistics – and not Interstate statistical Committee of the CIS – has been used to compile the trade data in Table 4. The reason for this is that the latter source lacks complete time series for all CIS countries, whereas the former has estimated indirectly trade turnover even for those countries which have failed to report data to the IMF.

might still be optimal in the theoretical sense, from a practical standpoint the challenge now facing the CIS is rather to formulate a "second-best" strategy in which a regional cooperation approach fills a vital role. What the countries in the CIS's southern tier primarily need is long-term cross-border cooperation to break the region's geographical exclusion. Coordinated infrastructure investment programmes, natural resource management, and harmonised and transparent border administration through a regional economic forum must be at the heart of a successful global integration effort.

It is worth noting that development strategies will differ significantly across the CIS, since regional integration is not sensible for all countries. The western parts of the CIS – Belarus, Ukraine, Moldova, and parts of Russia – are located close to the EU and other western markets. For these countries, it would make little sense to seek close integration with, for example, Tajikistan and the Kyrgyz Republic, especially if it would involve distortions in trade with the EU. Consequently, the argument for regionalism is relevant primarily for the Central Asian and Transcaucasian states. Irrespective of the constellation of participating countries it is, however, vital that Russia is actively involved because of the relative size of that country's economy and the transportation networks that run over Russian territory from the Caspian region to Europe and the Pacific coast. Also, the central and eastern parts of Russia could certainly benefit from increased trade with the Central Asian states.

Multilateralism and Regionalism are not Mutually Exclusive

Academic debates over regionalism and multilateralism sometimes seem to suggest that international trade strategy is an "either-or" proposition. Although some Bretton Woods institutions argue the contrary, history shows that WTO rules are sufficiently flexible to permit members to form regional development strategies, and the growth of "open regionalism" has not hindered the elaboration of non-discriminatory rules within the WTO framework (Bartlett 2001). Several developing countries have pursued multiple trade agendas in the post-war period. Mexico, for example, joined NAFTA just a few years after signing the GATT; Chile signed an FTA with Mercosur and stressed its desire to join NAFTA while continuing its aggressive pursuit of multilateral liberalisation. The strategy of the Kyrgyz Republic – joining the WTO, staying in the CIS FTA, and joining the EEC – illustrates the possibilities of trade policy formulation that converge towards multilateral norms while still retaining certain elements of regionalism.

Also, regional integration for several CIS countries might offer a quicker, more efficient, and more certain route to trade liberalisation than the lengthy negotiation process in the WTO. Provided that the trade blocs pursue generally open trade policies with the rest of the world, they may build a political basis for improved regional cooperation at limited economic cost. The isolationist CIS countries, such as Uzbekistan and Turkmenistan, are less likely to engage in multinational cooperation in the short term, since it is not clear that the dominant political institutions will clearly gain from open trade and liberalised economies. The prospect of liberalising initially within a regional context with some form of external protection may thus appear less politically overwhelming than adopting multilateral liberalisation right away. Even the most fervent free-trader has to admit that partial trade liberalisation is better than no liberalisation at all.

But what form of trade bloc would be advisable for the CIS? Aside from homogenising customs procedures and demonstrating political determination there appears to be little justification for maintaining a customs union in the CIS. As described above, customs union would likely have trade diverting effects as countries with relatively liberal trade regimes have to accept the Russian import duties as the common tariffs of the union due to Russia's superior economic bargaining power. This would be particularly complicated for the CIS countries which have already made tariff commitments to the WTO. An FTA, on the other hand, would involve more customs administration in intra-union trade than would a customs union, but on the other hand the cumbersome process of negotiating the common tariff would be eliminated. I believe that one of the stumbling-blocks for successful trade blocs in the CIS has been the overly ambitious agendas and the overwhelming political rhetoric preceding any real achievements. Creating a common market, or even a customs union, with supra-national authority is simply not yet viable in a region that has recently paid a very high price for independence. This holds particularly true for the case when Russia – the historic oppressor and imperialist – is allowed to control the organisation's agenda.

Rather than settling for a high common external tariff in a customs union, the participating countries might be spurred in an FTA to compete in lowering their trade barriers towards third countries in order to attract foreign investment. A necessary prerequisite for an FTA in the CIS is, however, that it allows for free trade in all goods, and that it is not subject to numerous exceptions for "strategically important products" meaning goods produced by low-efficient state monopolies. Apart from creating additional customs administration, such exceptions effectively prevent much-needed competition in protected industries.

Regionalism Enables Successful Multilateral Integration

A regional strategy in the CIS might result in important spillover effects. For example, detection of violations of trade agreements and sanctioning of defectors are easier in regional agreements than in multilateral ones. Also, a trade bloc lends additional political momentum to economic reform programmes in the sense that expansion of regional trade attracts Western multinationals, which are interested in securing intellectual property rights and other "behind the border" reforms.

It remains beyond doubt that trade policy reform, in general, and improvements in governance and the quality of institutions, in particular, are key to increasing the integration of the CIS countries into the world economy. There is, however, no clear blueprint for how to reform institutions. One vital factor – as underscored in particular by EBRD (2003) and UNDP (2005) – is the importance of "external anchors", including the WTO or the EU, in promoting institutional reform and liberal trade policy. For a large country, such as Russia, WTO accession may function as a major catalyst in accelerating and maintaining institutional reform. For small countries, WTO membership may have a more limited impact on the quality of institutions, because they attract less interest in enforcement by other WTO members,[45] but it could still be pivotal in other areas. Moreover, increased access to the EU market for the CIS countries – especially for those countries that border to EU members – would certainly serve as a significant impetus to trade. For a regional trade strategy to generate these spillovers in the CIS, it must thus be accompanied by WTO integration to anchor the CIS to liberal trade norms and establish mechanisms for solving trade disputes. Particularly for the smaller CIS countries, the WTO arbitration court could be used to settle trade disagreement with Russia, which would hold a superior position in a regional trade court.

[45] For example, in 1999 the Kyrgyz Republic was the first CIS country to join the WTO. However, in 2002 it received an average World Bank score for governance not much better than Kazakhstan's and worse than Russia's even though the latter two are not WTO members (EBRD 2003).

Regional Integration Facilitates Competition and Trade Financing

The dynamic effects of a comprehensive FTA in the CIS could potentially be exceedingly positive. First, the expanded market in an FTA would create the possibility for increased economies of scale. For competitive enterprises in small Central Asian and Transcaucasian economies an extended market would allow for unprecedented expansion. The basic premise is not that these enterprises should grow strong in a controlled economic environment in line with the "infant industry argument", but that existing competitive enterprises should be able to become increasingly competitive as they expand geographically and exploit economies of scale. Moreover, the freeing-up of trade and cross-border investments will expose domestic markets to much-needed competition. State monopolies and previously protected industries will find themselves in a considerably more competitive environment. Naturally, these adjustments will take several years because of legislative inertia and the poorly developed market conditions in most CIS countries, but they are bound to eventually take place.

Second, certain factors hindering intra-regional trade in the CIS can be at least partially mitigated through the introduction of export credits and other trade financing mechanisms. The aggregate population of Transcaucasia and Central Asia is over 73 million; adding Russia, Ukraine, Belarus, and Moldova raises the total to nearly 280 million. By any account, this represents a substantial market whose potential for intra-regional trade can be unlocked via appropriate forms of trade financing. Trade-creating possibilities would be even greater were the southern-tier CIS countries to further expand commercial relations with large non-CIS neighbouring countries, such as China, Iran, India, and Turkey. The ECO might function as a useful vehicle for this purpose.

Solving Regional Problems Requires a Regional Approach

Problems of energy transit and distribution disputes have to be solved in a regional context. As I have shown, problems related to energy and water are the major source of conflict in the CIS, and there is little hope of solving them bilaterally or exclusively within the WTO framework. However, if the inefficiencies that characterise the current energy policy could be solved together with issues on water distribution, electricity rights, and transportation on a regional level, all involved parties would gain tremendously. One of the crucial aspects of such an agreement has to be the incremental harmonisation of energy prices towards world market prices. This is bound to be an economically painful transition, but it is important for several reasons. First, CIS enterprises need to become increasingly competitive through the introduction of more energy-efficient technology and not through subsidised fuels, and second, a world market prices would put an end to barter transactions and also significantly reduce Russia's economic leverage vis-à-vis the CIS states. Although these issues initially unquestionably need to be settled on a regional level, the resulting agreement is likely to need international support and enforcement through a multilateral organisation. Once again, I find that combining regionalism and multilateralism in the CIS creates synergies rather than new problems.

Irrespective of which development strategy the countries of Central Asia and Transcaucasia choose to pursue, Russia's role in the future of the CIS countries is bound to be strong and influential. They will not be able to politically or economically distance themselves from Russia for a long time, and in a short- or medium-term perspective that might not even be desirable. One needs to remember that Russia is a rich country compared to most of its CIS neighbours, and that the Russian society – despite the disturbing tendency to restrict civil liberties – is a considerably more progressive, democratic, and liberal country than most CIS and non-CIS countries in the region. Indeed, China, Iran, Pakistan, Afghanistan, and Mongolia are no models of political pluralism.

Even though the EU, the USA, and Japan would all function as better anchors for democratic and economic reform, the geographic isolation and economic backwardness of the Central Asian and Transcaucasian states leave them with little other choice than to grab the best alternative at hand – economic integration with Russia – even if it is not the theoretically best option. There remains little doubt that Russia uses its economic strength to exert political concessions from the CIS states, but the allegation that Russia deliberately tries to keep its neighbours poor and under-developed should be discarded as a myth. After the outbreak of fundamentalist violence in Central Asia, Transcaucasia, and Chechnya, Russia is eager to protect itself primarily against religious extremism and ethnic violence. This battle has hitherto been fought with the Russian army on the territory of Russia and other CIS states, but the long-term solution – as everyone, including probably the Russian government, realises – can only be socio-economic improvements in the conflict-torn areas. If Russia involves itself to mitigate these problems, and at the same time opens its market for goods and services from the CIS states, it has to be regarded as at least a step in the right direction.

5.2 Conditions for Success

The five arguments above, which together outline a novel normative view of CIS integration, are not easily applied, but the promotion of a strategy based on a combination of regionalism and multilateralism is in my opinion considerably more realistic than an exclusively multilateral integration agenda. However, in order to execute the strategy the CIS states themselves must resolve, or at least initiate a process to resolve, the political disputes that now disturb both interstate cooperation and internal state consolidation. The unsettled war over Nagorno-Karabakh prevents the normalisation of Armenia's relations with Azerbaijan and Turkey; more than ten years after guns were put down, Turkey and Azerbaijan still maintain a complete trade embargo against Armenia. Continued unrest in Abkhazia, Ajaria, and Southern Ossetia threatens Georgia's domestic stability in the aftermath of the Rose Revolution in 2003. Troubled relations between the Central Asian states and civil strife in Tajikistan hinder a coordinated response to religious extremism and drug trade, and reinforce those countries' dependence on Russia, especially in the military field.

Nonetheless, I believe that the regional strategy proposed above has much better chances of moving the CIS countries towards real world market integration and increased welfare than an immediate and free-standing multilateral approach. Eventually, to compete in a global investment market, the CIS states must also – as emphasised by many economists, including Bartlett (2001), Michalopoulos and Tarr (2005), and UNDP (2005) – establish a stable legal environment: clearly defined property rights, predictable regulations, smooth border controls, and transparent financial and accounting rules. As long as domestic laws continue to be arbitrarily enforced, civil liberties regularly suspended and electoral processes corrupted to meet the partisan goals of incumbent politicians, it is difficult to imagine the creation of such an investor-friendly environment.

It is plausible that spillover effects of a regional trade agreement could stimulate movement on larger political problems, as suggested in the case of oil and gas transportation. The growing sense of shared security interest in the states of the CIS's southern tier and the utility of regional security cooperation organisations, such as the SCO, in addressing these may indeed – in parallel with or within the framework of a functioning trade bloc – open up a basis for greater trust and a compromise-seeking atmosphere needed to resolve difficult territorial and security issues.

6 CONCLUSIONS

The theory on economic integration indicates that a trade bloc with a few participating states, from a welfare point of view, can never be Pareto superior to multilateral economic integration. In trade theory wording, a regional trade bloc with barriers towards third countries is *ceteris paribus* likely to create less trade than a global trade bloc (or, equivalently, divert more trade). Yet in this thesis, I have argued that regionalism is a potential development strategy for the CIS countries. It has been shown that the prevailing economic policy agenda coupled with multilateral integration – a theoretically "first-best" solution – cannot by itself create the impetus required to integrate the CIS states into the world economy. The difficult political and security obstacles, geographic constraints, and historic legacies of the post-Soviet space have made firm economic integration with the world economy elusive in the short- and medium term, and, at the same time, crippled regional integration with conflict and distrust.

Nonetheless, I have attempted to show that a regional agenda could be part of an achievable "second-best" strategy, which provides the means for future world market integration. Whereas multilateral integration in the form of WTO membership would provide a necessary anchor for institutional reform and trade liberalisation in the CIS, a regional trade bloc would provide a forum for resolving crucial transportation and energy issues. Regional economic cooperation could thus serve as a vehicle for successful global integration. In particular, the geographic isolation and lack of means to effectively transport goods to and from the world market has made regional cooperation a crucial development component in Transcaucasia and Central Asia.

I believe that the international community – in the form of the IMF, the World Bank, the WTO, and the EU – should encourage Russia and the CIS's southern-tier countries to form a strong regional trade bloc (or continue to develop an existing one, such as the EEC) to unlock some of the most pressing mutual economic issues. At the same time, these Western organisations should support the WTO application processes of the CIS countries and make sure that the regional trade bloc meets international standards on transparency and trade liberalism. Lastly, international aid should be specifically targeted at improving the cross-border infrastructure in Central Asia and Transcaucasia in order to bring the region closer to the rest of the world.

7 SUGGESTIONS FOR FURTHER RESEARCH

The next step is this area of research would be to make a case study in a functioning trade bloc in the CIS. Thereby, it would potentially be possible to determine which – if any – of the five arguments in favour of regional economic integration advanced above have been realised. The closest one can get to free trade in the CIS at the moment is probably the Russia – Belarus Union; to be sure, this is not an ideal case as none of the countries is a WTO member and Belarus is one of the most backward country in the CIS in the sense that it is still dominated by a Soviet-style economic and political system. However, if Russia should become a WTO member (which might happen within the next few years), it would indeed be interesting to analyse the effects on the Belarusian economy.

Moreover, if the EEC develops into something resembling a functioning trade bloc with at least free trade (if not a common tariff), it could also serve as an important empirical case study, particularly in the light of the current energy and water disputes in Central Asia. Ideally, I would perform such a case study on the firm level in order to avoid problems of low-quality aggregate data. Furthermore, I would choose a consumer-product oriented company rather than an enterprise in an extractive industry, where foreign investment is already plentiful. For example, how would a large Kyrgyz dairy company, a Kazakh textile factory, or a Georgian concrete manufacturer develop in a market expanded through a free-trade agreement? It would also be interesting to see how transport costs in Central Asia and Transcaucasia develop over time when the countries in the region commence to pool infrastructure investment resources, agree on transit rules, and cut administrative red tape at border controls.

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APPENDIX 1: REGIONAL ECONOMIC INTEGRATION PROJECTS

The Commonwealth of Independent States (CIS)

MEMBERS: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan (associate member), Ukraine, and Uzbekistan.

HISTORY: The presidents of Russia, Ukraine, and Belarus formed the CIS in December 1991. The CIS was expanded to include eleven of the FSU countries at a meeting in the then Kazakhstan capital of Almaty on 21 December 1991. By 1993, all of the former Soviet republics except for the Baltic states had joined. In August 2005 Turkmenistan declared its intention to reduce its participation in the CIS to the status of associate member.

OBJECTIVES: The initial goals of the CIS were to coordinate foreign and security policies, to develop a common economic space with a common customs policy, to maintain orderly control over the military assets of the FSU, to develop shared transportation and communications networks, to preserve the environment and maintain environmental security, to regulate migration policy, and to take coordinated measures against organised crime (CIS 1991).

The CIS charter in 1993 expanded the organisation's duties to include protection of human rights and fundamental freedoms, and the coordination of defence policy and border protection (CIS 1993a).[46] During the first years of its existence, about 60 institutions were established in the CIS, most with highly specific coordinating functions. The most important main bodies set up were the Council of Heads of State and the Council of Heads of Government, but a few of the specialised bodies, such as the Inter-State Aviation Committee and the Council of Railroad Transportation, also filled vital roles.

The first real steps towards establishing a new institutional framework around the economic cooperation in the CIS was the adoption of an Economic Union Treaty in 1993. The intention of the new treaty was to eventually create a full economic union like the EU, comprising a free trade area, a customs union, including free movement of capital and labour, a payments union and a monetary union (CIS 1993b). Not all CIS members signed the treaty,[47] and the supplementing Agreement on the Creation of a Free Trade Zone, presented a few months later, was signed only by a few countries.

In September 1994, The Council of Heads of Government created the Inter-State Economic Committee on the basis of this treaty. The committee was intended to have executive and managerial powers over transnational systems such as power grids, natural gas and oil pipeline, and other shared transportation and communication systems. Furthermore, the committee was to develop a payments union and to administer the FTA in the CIS.

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[46] However, already in 1992, Armenia, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan had signed the CIS Collective Security Treaty. Azerbaijan, Belarus and Georgia signed in 1993. All signatories agreed to refuse the use or threat of force. In 1999, Azerbaijan, Georgia and Uzbekistan chose not to renew their commitment to the treaty and officially withdrew. In 2002, the six remaining members established the Collective Security Treaty Organisation (CSTO). Uzbekistan may consider joining CSTO again during 2006.

[47] The Treaty has been signed by nine CIS countries: Azerbaijan, Armenia, Belarus, Kazakhstan, the Kyrgyz Republic, Moldova, Russia, Tajikistan, and Uzbekistan. Ukraine has joined the agreement as an associate member, whereas Georgia and Turkmenistan did not sign it.

ACHIEVEMENTS: The institutional design of the CIS was in conflict with the objectives of many of its members from the outset. Quite a few of the goals of the CIS charter were explicitly integrative, but the institutional bodies meant to implement them were either purely consultative or were not mandated to enforce legally binding decisions. The CIS charter clearly specifies that the organisation possesses no supranational authority. The charter also contained no instruments of enforcement. Indeed, a prime obstacle to CIS success has been the outspoken reluctance of the member countries to abandon any decision-making powers to multi-state arrangements. Most of the problems that the CIS set out to solve remain unsolved.

The Economic Union has in the end provided even less economic integration in the CIS states than has the Customs Union. In 1995 and 1996 a new market economy and free trade seemed to be developing, which led to some revival and development of new trade within the region. The growth in trade was preceded by increased trade openness, but the volume of trade was still very small (Elborgh-Woytek 2003).[48] New protectionism and the contraction of trade emerged in 1997. In 1998, on average, exports to CIS countries by their CIS counterparts fell by 18 percent, largely due to the Russian financial collapse of 1998.[49]

As of 2006, even the CIS FTA is still nowhere to be seen. The signatory states concerned are still, despite frequent announcements of the contrary, unable to work out a common customs policy and to coordinate the range of goods that can be excised, as well as the required excise-tax rates and the value-added tax system.[50]

The Customs Union

MEMBERS: Belarus, Kazakhstan, the Kyrgyz Republic, Russia, and Tajikistan.

HISTORY: At the end of 1995, Russia, Belarus, and Kazakhstan establish the Customs Union. In January 1996 the CIS Council of Heads of State recommended that the Customs Union be expanded to include other CIS members as well, but only the Kyrgyz Republic joined. Tajikistan expressed immediate interest in joining, but it was not until 1999 it became a member.

OBJECTIVES: The three founding countries were interested in a quicker and broader economic cooperation than the CIS seemed to be able to provide, but they still conceived that the Customs Union was functioning within the CIS framework. The ultimate goal was to establish a full customs

[48] Elborgh-Woytek (2003) defines trade openness as the sum of imports and exports divided by GDP, adjusted for PPP. With this definition, she calculates that the trade openness ratio in the CIS rose from 5 percent in 1992 to about 15 percent in 1997. As a consequence of the financial crisis in Russia in 1998, trade openness declined gradually to around 12 percent in 2002. There are significant differences among the CIS countries, however. The trade openness in the Soviet Union in 1989 is estimated to have been approximately 8 percent. As a comparison, trade openness in the EU was approximately 65 percent in 2002 using the same calculation (EBRD 2003).

[49] The financial crisis across Asia in 1997, spread to the FSU, but particularly to Russia, in 1998. Despite a large IMF-led financial package of $22.6 billion offered in July, the Russian deficit and short-term debt were too large to sustain the confidence of bond investors. On 17 August 1998, Russia devalued the ruble, defaulted on its foreign debt service, and declared a moratorium on its foreign debt service. For a more detailed overview of the Russian financial crisis, see Åslund (2002) and Hedlund (2001).

[50] Russia and other CIS states in 1992 adopted the practice of applying value-added tax (VAT) to goods shipped to other CIS countries, but not to exports outside the CIS. This system defies world practice, which is to exempt exports from VAT. International advisers urged member states to change this practice, but the states did so in an uncoordinated fashion, so that, for example, in the summer of 1997, Kazakhstan and the Kyrgyz Republic decided bilaterally to charge VAT on imports and not on exports, while Russia and Belarus levied VAT on exports. Consequently, Russian and Belarusian companies had to pay VAT twice when exporting to Kazakhstan and the Kyrgyz Republic. Eventually, most VAT issues have been solved on a bilateral basis (Michalopoulos and Tarr 2004).

union with harmonised external tariffs between the participating countries in order to boost trade and economic cooperation. In March 1996, the four Customs Union member states signed an Agreement on Increased Integration in the Economic and Humanitarian Spheres, which came to serve as the foundation of the Customs Union.

ACHIEVEMENTS: In 1996, Russia unilaterally decided to raise tariffs without prior consultation with the other Customs Union members. Even after joining the Customs Union, the Kyrgyz Republic was forced to continue purchasing grain on the world market, because Kazakhstan, its neighbour and fellow union member, applied a 20 percent export tariff. Furthermore, the Kyrgyz Republic had to buy oil from China instead of Kazakhstan for the same reason. When combined, the problems of the Customs Union made further economic integration impossible, and the member states did all but nothing to solve them. The Customs Union was thus never a functioning customs union.

Eurasian Economic Community (EEC)

MEMBERS: Belarus, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan, and Uzbekistan.

HISTORY: The EEC[51] was established in May 2001 by Belarus, Russia, Kazakhstan, the Kyrgyz Republic, and Tajikistan. In 2002, Moldova gained observer status in the EEC, and in January 2006 Uzbekistan became the sixth full member of the organisation.

OBJECTIVES: The primary goals of the EEC are the establishment of a common market for labour and capital, free intra-community trade and trade policy harmonization among the participating countries. The 2004 summit in Almaty declared that an important component is the coordination of WTO accession by the member states.

ACHIEVEMENTS: The EEC was founded when it became clear that the Customs Union would fail to deliver real integration. The EEC, like its predecessor, has faced many difficulties in establishing a common external tariff, principally because Kazakhstan and the Kyrgyz Republic have not accepted the Russian tariff as the common tariff of the union (UNDP 2005).[52] Russia in turn is unlikely to accept the low Kyrgyz tariffs, which are bound by treaty since that country's 1998 WTO accession. In 2004, it was reported that Russia and Belarus had harmonised approximately 95 percent of tariff lines; Russia and Kazakhstan approximately 85 percent; Russia and the Kyrgyz Republic 14 percent; and Russia and Tajikistan approximately 60 percent (Michalopoulos and Tarr 2004). Furthermore, all four countries have applied to the WTO on the basis of individual tariff schedules rather than as a customs union, which reveals the low level of commitment of the participating countries to achieve real integration.[53]

Central Asian Cooperation Organisation (CACO)

MEMBERS: Kazakhstan, Kyrgyz Republic, Russia, and Tajikistan.

[51] The EEC is also known as EAEC and EURASEC, or EurAsEC.

[52] Already during the existence of the Customs Union, Belarus, Kazakhstan, and Russia had negotiated a common external tariff on the basis of Russia's tariff, but soon they all began to introduce unilateral modifications.

[53] The EEC member countries have applied individually to the WTO despite the fact that the GATT (1947) specifies that '[e]ach such customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party…' (Article XXIV, Section 1).

HISTORY: At a January 1993 meeting, the Central Asian states agreed to pursue a policy aimed at creating a common market and establish and interrepublic Coordinating Council. A year later, in 1994, the presidents of Kazakhstan, Uzbekistan, and the Kyrgyz Republic agreed to make a common economic space of their countries: the Central Asian Economic Community (CAEC). They also founded the Central Asian Bank for Cooperation and Development (CABCD). Tajikistan gained observer status of the CAEC in 1995, but became a member only in 1998. Turkmenistan has refused to join the organisation. On 28 February 2002, the CAEC was transformed into the CACO. On 28 May 2004, Russia joined CACO as a member, and in October 2005 CACO was absorbed by the EEC.

OBJECTIVES: The main goal of the CAEC was to create a single economic space, but the CACO, additionally, aimed at enhancing 'the development of the economic integration in the region, the perfection of the forms and mechanisms of the political, social, scientific-technical, cultural and educational relations' between member states.

ACHIEVEMENTS: With the exception of some improvements in tax harmonisation, a partial elimination of double taxation, and the establishment of the CABCD, the steps taken within the CAEC framework were relatively unsuccessful. Indeed, the numerous resolutions adopted were only rarely followed by implementation measures. One of the main purposes of creating CACO was to leave the failures of the CAEC behind.

During the years of its existence the CAEC failed to develop into an instrument of serious economic cooperation. The CABCD has been chronically underfunded and it has only undertaken a handful of large projects, none of which commercially successful.[54] The Central Asian leaders have displayed little real interest in solving the economic problems of the region on an interstate level. One of the few exceptions is the TRACECA project to create a new Silk Road. Although creating an FTA was one of the explicit objectives of the CAEC, Central Asia shows no signs of reaching this goal in the near future. All the member states are far more concerned with their national security than with promoting closer economic ties with their neighbours (Olcott, Åslund, and Garnett 1999).

Despite Tajikistan's admittance to the CAEC, the Tajik-Uzbek border in Leninobad oblast has essentially been closed, first because the Uzbek government did not want its relatively cheaper goods to flow into Tajikistan, and then because the Tajiks did not want political opposition groups to be able to infiltrate from Uzbekistan. In the late 1990s, Uzbekistan mined its borders with the Kyrgyz Republic and Tajikistan in an effort to prevent drug trafficking, weapons smuggling and incursions by members of the Islamic Movement of Uzbekistan. In 2002, Uzbekistan effectively closed its borders with Kazakhstan and the Kyrgyz Republic, officially to protect against epidemics, but in fact also preventing people from visiting, shopping or working in the neighbouring countries. There have been numerous fatalities at the borders between Uzbekistan and other republics due to either shootings by border guards or land mines. Uzbekistan has, however, recently removed mines from its border with the Kyrgyz Republic and is currently removing mines from its border with Tajikistan (UNDP 2005).

[54] The founding nations - the Kyrgyz Republic, Uzbekistan, and Kazakhstan – each pledged a third of the $9 million starting capital of the CABCD. When the Central Bank of Kazakhstan revoked the banking licence of CABCD in 2002, it was soon decided that the bank should be liquidated. As of 2005, the CABCD was still in the liquidation process and the contributing countries were struggling to recover their financial contributions (AKIpress 2003; 2004).

The integration of Russia into the CACO changed the centre of gravity of the organisation, and the merger of CACO and the EEC in 2005 was hardly surprising in that respect. On the same day that Russia joined the organisation, the Uzbek President Karimov proposed the establishment of a Central Asian Common Market (CACM), based on the CACO institutional framework and including Afghanistan. The key objective of the CACM would be to improve living standards in the member states through better use of regional resources, including water and energy, and natural, physical and human capital; and by developing common strategies for creating a favourable investment climate for domestic and foreign investors. The first phase towards the CACM was envisioned to include a FTA within five year, and, in a second phase, a customs union after another five years. Finally, a common market should be formed as an economic union after an additional five to seven years (ITAR TASS 2004). Since the proposal was made in May 2004, however, there has been little notable progress in further deepening and implementing it.

GUAM

MEMBERS: Georgia, Ukraine, Azerbaijan, and Moldova.

HISTORY: In October 1997, the presidents of Georgia, Ukraine, Azerbaijan, and Moldova met in Strasbourg during a Council of Europe Summit and officially stated their mutual interest in developing bilateral and regional cooperation as well as European and regional security. In April 1999, Uzbekistan joined the group during a NATO summit in Washington; GUAM became GUUAM. In 2002, however, Uzbekistan decided to suspend its membership in the organisation, but it continued to attend the high-level meetings of the organisation. After a meeting in Chisinau, Moldova, in April 2005, Uzbekistan officially withdrew from the organisation and the organisation was thus left with its original four members. The name of the organisation also changed back to GUAM.

OBJECTIVES: The four member countries initially identified a number of issues where coordination would be mutually beneficial, such as regional conflict resolution and peacekeeping, making energy supplies reliable, the creation of an Asian-Europe transit corridor, cooperation in international organisations, and the promotion of closer contacts with the West. Later, the GUAM group formulated a much broader agenda: 'To foster favourable conditions conductive to economic growth among the participating states, mutually beneficial trade relations, and implementing complex multilateral programs and projects in the fields of production, commerce, energy, transport, the economy, international credit and financial cooperation, border, customs and fiscal services, communications, science, technology education and culture, direct contacts between different state bodies and departments of the respective agencies of the GUUAM Group Member States will be implemented' (GUAM 2006).

ACHIEVEMENTS: At its formation the GUAM group was careful to deny that it was creating a counterbalance to Russia or any other country. Nevertheless, at least some Russian observers see GUAM as a potential threat to their country's interests (Olcott, Åslund, and Garnett 1999). From a broad perspective, the GUAM group represents a direct refutation to the way in which Russia favours to view the post-Soviet space. The foreign policies of all the GUAM members are opposed to key elements of Russia's foreign policy designs. For example, the countries have taken a joint stance on the CFE flank limitation negotiations as a counterblock to Russia, and at the end of 1998, the group considered creating joint peacekeeping forces in the Caspian and Black Sea regions.[55] Ukraine had already taken a larger role in the mediation of the Transnistria conflict in mid-1997, and Georgia, like Moldova, has long sought Ukrainian participation in peacekeeping to counterbalance Russian influence. They all support transportation and pipeline routes at odds with Moscow's proposals. A fundamental constraint on GUAM's effectiveness, however, is the bilateral relationship that each of its members has with Russia. Georgia, Ukraine, Uzbekistan, Azerbaijan, and Moldova are each more dependent upon and vulnerable to Russia than they are committed to each other (Olcott, Åslund, and Garnett 1999).

Despite all its inherent weaknesses the GUAM group has proved itself a useful forum for cooperation, allowing its five members to coordinate and pool their influence on a limited set of issues of mutual concern. Since the 11 September attacks and the ensuing war in Afghanistan, addressing the issue of regional security appears to be the most important objective of the organisation. In 2002 the member states agreed to establish an FTA among the member states, but this project found little real support. During 2005 the need for increased economic integration within the GUAM framework was once again emphasised; this time by Ukraine's President Viktor Yushchenko. Georgia and Moldova have backed the Ukrainian plans to revitalise the organisation.[56]

Russia – Belarus Union

MEMBERS: Belarus and Russia

HISTORY: The first moves towards closer integration came under Belarusian Prime Minister Vyacheslav Kebich, who in September 1993 concluded a major bilateral agreement that was said to create 'a new kind of Ruble Zone', followed shortly by an agreement on monetary union in January 1994. The Treaty on the Formation of a Union State was signed on 8 December 1999. The Treaty has been ratified by each country's parliament at an overwhelming majority.

OBJECTIVES: The Treaty on the Formation of a Union State was perceived as a 'further stage in the process of unification of the two countries' (Russia – Belarus Union 1999). The ultimate goal of the integration efforts is to create formal unification in a number of areas, including monetary policy, defence, and social policies.

ACHIEVEMENTS: Vyacheslav Kebich's desire for a currency union in the early 1990s was primarily driven by the collapse of the Belarusian economy. The initial proposal of one-to-one exchange of Belarusian for Russian rubles would have been very disadvantageous for Russia, and the currency union has thus so far not been implemented.

His successor, President Alexander Lukashenko, campaigned persistently for Russian-Belarusian integration. A draft treaty in March 1997 proposed to create a formal union of the two countries. Though explicitly preserving the state sovereignty of both states, the draft treaty

[55] The Treaty on Conventional Forces in Europe (CFE) was originally signed in 1990. The Treaty established comprehensive limits on key categories of conventional military equipment in Europe and provided for the destruction of weaponry in excess of those limits. The treaty proposed equal limits between the two "groups of states-parties", at the time NATO and the Warsaw Pact. When the flank limitations of the Treaty were revised in 1996-1997, Russia complained that the current limits did not allow it to deploy adequate forces in regions of 'serious security concern'. The GUAM countries, fearing increased Russian military presence in their region and a legitimisation of continued presence of Russian forces, which at that time still were stationed in Georgia, Moldova, and Ukraine, opposed a renegotiation of the flank limitations.

[56] Ukraine's Minister of Foreign Affairs, Borys Tarasiuk, has even suggested renaming GUAM the 'Commonwealth for Democracy and Development' (Ukrainian News 2005).

envisioned dual national and union citizenship and the establishment of a High Council for coordinating key issues of political, economic, and security policy. The draft treaty, however, was never signed. Instead, a watered-down memorandum of agreement was approved. Russian opponents of the original agreement argued that the integration with politically backward and economically depressed Belarus would entail huge costs for Russia. Belarus also had hesitations about what might happen to its sovereignty if it were more closely bound to a much larger and more powerful partner.

The resignation of Russia's President Boris Yeltsin on 31 December 1999, and the election of Vladimir Putin in the presidential election in March 2000, fundamentally changed the power balance in the Union State.[57] The areas of cooperation envisioned today reflect more Russian concerns than before. While one of the main objectives of the Union at its creation was deeper economic integration, the main integration development has taken place in the area of defence and security, with the formation of a joint Russian-Belarusian military group (Deyermond 2004). Belarus has also become a part of the Russian air defence system.

A monetary union was supposed to be implemented under the 1999 agreement. Plans to introduction the Russian ruble as the common currency on the Union's territory from 1 January 2005, were postponed until one year later. Once again, however, the introduction was postponed, this time until 1 January 2008. Belarus's insistence on having its central bank recognised as a second issuing centre of money has provided a major obstacle in the negotiations on the common currency union. A second problem has been the question of Russian subsidised energy supplies to Belarus. Russia insists on revising the current payment scheme, by which Belarus imports oil and natural gas from Russia at prices significantly below world market levels. The adoption of the Union Constitution has also been postponed at several occasions, and has not yet been signed.

Single Economic Space

MEMBERS: Belarus, Kazakhstan, Russia, and Ukraine.

HISTORY: The Single Economic Space (SES) was created on 19 September 2003, during a CIS summit in Yalta. Implementation of the agreement remains to be completed.[58]

OBJECTIVES: The objectives of the member countries when setting up the SES varied considerably. Russia and Belarus were aiming at establishing a customs union and a monetary union based on the Russian ruble. Kazakhstan would have supported this idea under the condition that the common currency was not the ruble, but a completely new currency called the "Altyn". Ukraine rejects the idea of a monetary union as this is in conflict with the country's strategic pro-EU objectives (UNDP 2005). Ukraine thus wishes to limit its participation in the SES to the FTA, the only objective considered compatible with its constitution. The SES is intended to be

[57] During the second term of Boris Yeltsin's presidency in Russia in 1996-1999, it was rumoured that Alexander Lukashenko pushed hard for increased integration with Russia, so that he could succeed the unhealthy Yeltsin as president of a Union State if Yeltsin should die from one of his frequent heart attacks. When the young and vigorous Vladimir Putin (who holds a black belt in judo and rarely drinks alcohol) became Yeltsin's favoured successor in 1999, Lukashenko allegedly realised that his chances of becoming president of a Union State were slim.

[58] The Single Economic Space is sometimes referred to as the "Common Economic Area" or the "Common Economic Space". The Russian official name *Yedinoye Ekonomicheskoye Prostranstvo* is, however, best translated as "Single Economic Space".

administered by a single regulatory body, the decisions of which will be obligatory to the member states.

ACHIEVEMENTS: One of the major impediments to success is the provision in the SES agreement to allow for the member states to decide individually their desired level of integration. Rather than creating increased flexibility for the member states, this provision threatens to obstruct the integration process. Another important issue, just as in the case of the EEC, is the fact that all SES member states are individually applying for WTO membership, and it might be case that this new integration initiative actually lowers their chances to achieve member status. The outcome of the 2004 presidential election in Ukraine, when President Putin actively supported Viktor Yanukovych, the opponent of the west-oriented future president Viktor Yushchenko, makes progress with cooperation even less likely.

Other Regional Trade Blocs

CIS countries have entered into a number of multilateral trade agreements, which encompass countries outside the CIS as well.[59]

Black Sea Economic Cooperation

MEMBERS: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia and Montenegro, Turkey, and Ukraine.

HISTORY: The Black Sea Economic Cooperation (BSEC) was established by the Istanbul Summit Declaration of the BSEC on 25 June 1992. The BSEC Permanent Secretariat was formed in March 1994, and the organisation was officially inaugurated on 1 May 1999.

OBJECTIVES: The general goals of the BSEC are to accelerate economic and social development of the member states in various areas such as energy, tourism, science and technology, transportation and electric networks, protection and promotion of investments, taxation, industrial and commercial cooperation, economic and legislation information, and agriculture. The BSEC has created institutions in each of its areas of interest, including a trade and development bank. The 2001 BSEC Economic Agenda calls for the removal of numerous barriers to trade, and the reinforcement of the legal infrastructure. Furthermore, the Agenda defines as a long-term objective to set up an FTA among the BSEC member countries (BSEC 2006).

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[59] Note that I have in this section only included organisations, which have a clearly stated *economic* integration agenda, including some kind of trade bloc formation. There are several other active regional organisations, which include countries of the CIS, but which mainly focus on defence and other security-related issues. The Shanghai Cooperation Organisation (SCO), for example, comprised of Russian, Kazakhstan, the Kyrgyz Republic, Tajikistan, Uzbekistan, and China, was officially founded in 1996. The organisation has mainly worked with border issues and security (especially with anti-terrorism measures) but in 2003 a program was adopted, which determined the 'basic goals and objectives of economic cooperation within the SCO framework, priority directions and concrete practical steps of cooperation with special emphasis on long-term planning,' and also 'pointed out to a course of SCO economic cooperation, free movement of goods, capital, services and technologies for a period of two decades' (SCO 2006). However, there have been no concrete moves towards trade agreements within the framework of this organisation yet. Also, the Central Asia Regional Economic Cooperation Initiative (CAREC) was founded by the Asian Development Bank in 1997 and comprises Azerbaijan, China, Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan, and Uzbekistan. The objective of the CAREC is to promote economic growth and raise living standards by encouraging economic cooperation in the Central Asian region. For a full description of regional organisations in Central Asia, see UNDP (2005).

ACHIEVEMENTS: Although the organisation has been active for over ten years, few concrete results have been achieved. The primary obstacles to success are considered to be conflicts and political rivalry between member states and difference in market size and levels of development. Moreover, many of the BSEC member states are members also of other organisations working with largely the same agenda.

Economic Cooperation Organisation

MEMBERS: Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan.

HISTORY: The Economic Cooperation Organisation (ECO) was created in 1985 by Iran, Pakistan, and Turkey on the basis of the Regional Cooperation and Development organisation and of its founding Treaty of Izmir. The ECO had no real function until 1992, when it invited as members the six CIS states with predominantly Muslim populations, namely Azerbaijan, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan. Afghanistan also became a member of the ECO in 1992. The ECO adopted its fundamental charter and the Implementation Plan on Reorganisation and Restructuring of the Organisation in 1996. The ECO started its activities with a new organisational structure in 1997.

OBJECTIVES: The amended Treaty of Izmir calls for the ECO to promote conditions for sustainable economic development and to raise the standard of living and quality of life in the member states through regional economic cooperation, and the progressive removal of trade barriers within the ECO region and the expansion of intra- and inter-regional trade. The group's general goal was to create a version of the EU for the Muslim states of the region.

ACHIEVEMENTS: In spite of the ineffectiveness of previous agreements, in 2003 the ECO member states signed the ECO Trade Agreement (ECOTA). This preferential tariffs agreement developed in cooperation with the United Nations Development Programme (UNDP) is intended to lead to a reduction in the highest tariff slab of each item to a maximum of 15 percent on at least 80 percent of all goods at the end of eight years, and to a reduction of para- and non-tariff barriers among member states (BBC 2003). Also, the ECO countries agreed in 2004 to make the establishment of an FTA by 2015 a high priority for the organisation (BBC 2004). The three founding members – Iran, Pakistan, and Turkey – already offer preferential treatment to each other, but the list of eligible products is very restricted. The five Central Asian countries, together with Afghanistan and Azerbaijan, have expressed commitment to ECO principles, but have so far made no moves towards preferential tariffs (UNDP 2005).

APPENDIX 2: MAP OF THE FSU

APPENDIX 3: INTRA-CIS TRADE OF CIS COUNTRIES

Million USD	1992		1994		1996		1998		2000		2002		2003	
	Exports	*Imports*	*Exports*	*Imports*	*Exports*	*Imports*	*Exports*	*Imports*	*Exports*	*Imports*	*Exports*	*Imports*	*Exports*	*Imports*
Azerbaijan	730	607	275	486	290	340	232	405	235	376	244	651	334	851
Armenia	-	-	158	206	128	278	81	230	73	174	96	302	129	310
Belarus	-	-	1,479	2,092	3,764	4,570	5,160	5,555	4,399	6,070	4,384	6,295	5,453	8,006
Georgia	-	-	117	272	129	270	107	267	132	227	169	290	241	358
Kazakhstan	-	-	1,874	2,177	3,179	2,946	2,108	2,054	2,337	2,732	2,194	3,031	2,981	3,920
Kyrgyz Republic	241	350	223	210	393	487	231	441	207	299	169	323	201	411
Moldova	304	461	406	476	543	653	429	440	276	260	351	409	424	593
Russia	-	-	14,082	10,317	15,895	14,549	13,699	11,313	13,856	11,604	15,711	10,163	20,450	13,624
Tajikistan	84	122	93	233	331	383	203	446	374	560	188	547	139	599
Turkmenistan	-	-	1,651	686	1,072	561	152	478	-	-	-	-	-	-
Ukraine	4,118	4,843	5,619	7,838	7,405	11,176	4,202	7,897	4,498	8,040	4,377	8,968	6,048	11,508
Uzbekistan	-	-	1,583	1,401	890	1,517	793	869	-	-	-	-	-	-
Totals	**5,476**	**6,384**	**27,557**	**26,392**	**34,019**	**37,729**	**27,397**	**30,395**	**26,388**	**30,341**	**27,884**	**30,979**	**36,399**	**40,180**
Total Trade	**11,860**		**53,949**		**71,747**		**57,792**		**56,728**		**58,863**		**76,579**	

Source: Interstate Statistical Committee of the CIS

APPENDIX 4: CIS TRADE WITH RUSSIA

CIS Trade with Russia (percentage of total CIS trade)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Azerbaijan	34%	37%	43%	46%	47%	58%	57%	35%	42%	45%
Belarus	85%	77%	79%	84%	87%	88%	89%	91%	93%	93%
Georgia	20%	38%	46%	41%	50%	48%	45%	42%	40%	40%
Kazakhstan	67%	77%	79%	80%	79%	80%	83%	78%	77%	76%
Kyrgyz Republic	30%	35%	35%	38%	43%	41%	39%	35%	40%	45%
Moldova	68%	62%	63%	69%	66%	67%	61%	57%	52%	49%
Tajikistan	33%	32%	21%	24%	23%	25%	39%	31%	34%	31%
Turkmenistan	11%	10%	6%	15%	26%	-	-	-	-	-
Ukraine	77%	82%	77%	75%	82%	80%	75%	70%	71%	74%
Uzbekistan	23%	57%	0%	59%	54%	-	-	-	-	-
Total Intra-CIS Trade	**34%**	**41%**	**39%**	**41%**	**44%**	**44%**	**43%**	**42%**	**43%**	**43%**

Source: Interstate Statistical Committee of the CIS

CIS Trade with Russia (percentage of total trade)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Armenia	32%	24%	19%	25%	21%	18%	15%	19%	17%	15%
Azerbaijan	18%	14%	17%	21%	18%	16%	12%	6%	10%	10%
Belarus	54%	50%	52%	59%	59%	56%	58%	60%	58%	58%
Georgia	16%	17%	21%	16%	17%	19%	16%	17%	17%	16%
Kazakhstan	40%	47%	47%	39%	34%	26%	30%	31%	25%	25%
Kyrgyz Republic	19%	24%	23%	22%	21%	17%	19%	16%	18%	21%
Moldova	49%	40%	40%	41%	34%	31%	26%	27%	23%	23%
Tajikistan	10%	15%	11%	12%	11%	15%	25%	17%	17%	14%
Turkmenistan	7%	5%	4%	9%	10%	-	-	-	-	-
Ukraine	50%	49%	45%	37%	37%	34%	33%	30%	27%	28%
Uzbekistan	13%	23%	0%	18%	14%	-	-	-	-	-
Total Intra-CIS Trade	**12%**	**14%**	**13%**	**13%**	**14%**	**12%**	**12%**	**12%**	**11%**	**11%**

Source: Interstate Statistical Committee of the CIS

APPENDIX 5: CIS TRADE BLOC MEMBERS

	CIS	Customs Union	EEC	CACO†	GUAM	R - B Union	SES	BSEC	ECO
Armenia	M		O					M	
Azerbaijan	M				M			M	M
Belarus	M	M	M			M	M		
Georgia	M			O	M			M	
Kazakhstan	M		M	M			M		M
Kyrgyz Republic	M	M	M	M					M
Moldova	M		O		M			M	
Russia	M	M	M	M		M	M	M	
Tajikistan	M	M	M	M					M
Turkmenistan	A								M
Ukraine	M	M	O	O	M		M	M	
Uzbekistan	M		M	M	M‡				M

Note: M represents “member status”; O “observer status”, and A “associate member”.

† CACO merged with the EEC in October 2005; Turkey had observer status in the CACO.

‡ Uzbekistan left GUAM in May 2005.

Source: Official organisation homepages

APPENDIX 6: GDP PER CAPITA IN THE CIS

GDP per capita (PPP, curr. int. USD)	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Armenia	1,736	1,497	1,506	1,671	1,779	1,839	2,079	2,209	2,422	2,733	3,138	3,671	4,222
Azerbaijan	..	2,313	1,874	1,673	1,734	1,816	2,002	2,177	2,571	2,877	3,218	3,617	4,175
Belarus	4,098	3,863	3,494	3,201	3,360	3,831	4,215	4,430	4,802	5,163	5,542	6,065	6,906
Georgia	1,762	1,309	1,217	1,329	1,494	1,569	1,688	1,775	1,990	2,151	2,333	2,666	2,977
Kazakhstan	4,214	3,845	3,479	3,318	3,428	3,602	3,624	3,903	4,594	5,330	5,897	6,663	7,494
Kyrgyz Republic	1,630	1,414	1,167	1,123	1,208	1,352	1,391	1,460	1,560	1,635	1,629	1,755	1,928
Moldova	1,937	1,958	1,395	1,417	1,298	1,357	1,290	1,267	1,290	1,364	1,477	1,512	1,742
Russia	7,110	6,653	5,914	5,814	5,758	6,000	5,894	6,360	7,086	7,573	8,130	9,033	9,863
Tajikistan	1,251	1,060	846	758	657	653	682	729	803	908	971	1,091	1,193
Turkmenistan	4,219	3,748	2,992	2,843	2,643	2,271	2,458	2,894	3,668	4,303	5,140	5,943	7,021
Ukraine	6,229	5,592	4,344	3,962	3,649	3,629	3,653	3,756	4,109	4,572	4,906	5,490	6,317
Uzbekistan	1,343	1,310	1,243	1,233	1,257	1,328	1,371	1,435	1,516	1,600	1,664	1,737	1,871
Unweighted average	**3,230**	**2,880**	**2,456**	**2,362**	**2,356**	**2,437**	**2,529**	**2,700**	**3,034**	**3,351**	**3,670**	**4,104**	**4,643**

Source: World Development Indicators Database

APPENDIX 7: COMMODITY CONCENTRATION OF EXPORTS SHARE OF THE THREE MAIN EXPORT PRODUCTS (IN PERCENT)

		1995	2001
Armenia	Precious stones and metals	33%	35%
	Base metals and articles thereof	11%	12%
	Minerals and chemicals	17%	12%
	Total	61%	59%
		1994	2002
Azerbaijan	Oil and oil products	33%	89%
	Cotton	16%	1%
	Metals	17%	1%
	Total	65%	91%
		1995	2002
Belarus	Machine building and metal processing	33%	26%
	Refineries products	12%	21%
	Chemicals and petrochemicals	27%	14%
	Total	71%	61%
		1995	2002
Georgia	Aircraft parts	0%	16%
	Unfinished products of iron and steel	22%	14%
	Beverages, spirits and vinegar	8%	14%
	Total	30%	44%
		1995	2002
Kazakhstan	Oil	17%	51%
	Steel products	15%	10%
	Copper	11%	7%
	Total	42%	68%
		1995	2001
Kyrgyz Republic	Nonferrous metallurgy	15%	52%
	Electric Energy	10%	10%
	Machine building	11%	12%
	Total	36%	74%
		1994	2001
Moldova	Beverages, spirits, vinegar and tobacco	40%	44%
	Vegetable products	18%	14%
	Textiles and textile products	5%	19%
	Total	63%	77%
		1994	2002
Russia	Oil and oil products	25%	27%
	Gas	16%	15%
	Metals	18%	14%
	Total	59%	57%
		1994	2001
Tajikistan	Aluminum	56%	61%
	Cotton fiber	28%	11%
	Electricity	5%	12%
	Total	89%	84%
		1994	2002
Turkmenistan	Gas	66%	58%
	Oil and oil products	9%	14%
	Cotton fiber	17%	6%
	Total	91%	78%
		1996	2002
Ukraine	Ferrous and nonferrous metals	33%	39%
	Machinery	14%	15%
	Agricultural products	21%	13%
	Total	68%	67%
		1994	2001
Uzbekistan	Cotton	51%	24%
	Gold	13%	28%
	Energy	0%	12%
	Total	64%	65%

Source: Elborgh-Woytek (2003, p. 8)