

The 2010 Russia-Belarus-Kazakhstan Customs Union

A CLASSIC CASE OF *PRINUZHDENIE K DRUZHBE* (FRIENDSHIP ENFORCEMENT)¹

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The Customs Union (CU) between Belarus, Kazakhstan, and Russia signed in November 2009 and enacted on July 1, 2010, was a breakthrough integration project in the post-Soviet space. It happened just as all other regional unions and agreements – the Commonwealth of Independent States (CIS), the Eurasian Economic Community (EURASEC), the Collective Security Treaty Organization (CSTO), and the Union of Belarus and Russia – have been failing due to conflicting interests and the lack of political will to honor and enforce treaties.

The CU has the potential of being yet another failed accord. It lacks strong political will from the signatories. It introduces common rules in an area of conflicting interests. It has received a dose of negative publicity in Belarus and Kazakhstan because of its potential adverse effects (and unclear benefits). Finally, it was enforced, at least in the case of Belarus, in a rather scandalous manner by means of coercion and blackmail.

However, the CU has a strong and committed leadership in the form of the Russian Federation, which clearly sees the union as part of its grand strategy of retaining what is left of its influence in the post-Soviet sphere. In the end, the CU largely represents a zero-sum game where one party has all the gains and the others are compelled to join in order not to make their conditions worse.

Union Members: An Odd Trio

Belarus, Russia, and Kazakhstan, once closely linked republics of the Soviet Union, would benefit enormously from the restoration of their “lost” economic ties. This core regional outlook of the old Soviet central economic planners is most often mentioned as the primary rationale for creating the CU today. However, the fact is that these are three independent states, which are now pursuing distinct models of development with different economic structures. On paper, they are an odd trio for an economic union. Russia and Kazakhstan are resource-based economies, while Belarus is an industrial

¹ This euphemism is derived from *prinuzhdenie k miru* (peace enforcement), which was used with regard to the role of Russian troops in the August 2008 Russian-Georgian war.

and transit economy. Russian and Kazakh foreign trade is oriented toward the European Union while China is rapidly emerging as the second most important trade partner for both countries. Belarus is more tightly integrated into the post-Soviet space, with 32 percent of its exports and 58 percent of its imports involving Russia in 2009. Russia's share in Kazakhstan's imports in 2009 was almost 31 percent, and only 8.2 percent in exports. Belarus and Kazakhstan have less than one percent in foreign trade between them. Given the differences in the countries' economic structures and foreign trade compositions, it is rather difficult, if not impossible, to find a win-win formula for the CU.

The CU tariff configuration was based on Russia's tariff system (92 percent of the tariff arrangement was based on current Russian excise rates). This has different consequences for Belarus and Kazakhstan, with their different economic structures and varying integration levels with Russia.

Belarus, which has had a de jure customs union with Russia since 1995, found most of its tariffs already synchronized (90 percent). Three quarters of its tariffs remained unchanged after the CU came into force, 16 percent were lowered, and 8 percent were raised. However, the average overall tariff did increase, which was the consequence of elevating customs duties on goods that were heavily protected by Russia (foodstuffs and industrial machinery).²

For Kazakhstan, the CU was far more revolutionary in changing its trade regime. Because only 38 percent of its duties were unified with Russia prior to signing the agreement, the effect was felt instantaneously. Even after Kazakhstan managed to secure a national trade regime for its vast array of sensitive goods, about one third of its customs duties have changed since the start of 2010. Due to its less sophisticated and diverse economic structure, which is typical of a resource-rich state, Kazakhstan had a rather liberal trade regime, particularly in foreign consumer goods. This made the country an attractive "transit point" for distributing Chinese goods across the region. Kazakhstan had a very high limit on the volume of imported goods: one individual could bring up to 2 tons of goods into the country duty-free. This ended with the enactment of the CU and Russian regulations, whereby goods weighing in excess of 50 kilograms per individual are liable to prohibitive duties. The prospect of such abrupt changes and price increases even provoked political protests in Kazakhstan.

Why Would Russia Want a Customs Union?

Significant quantities of Russia-China trade go through Kazakhstan. Likewise, a significant amount of Russia-EU trade goes through Belarus. The CU, when viewed as a political project, reflects the intention of Russia to obtain control over the periphery of the post-Soviet space. Indeed, Russia is the prime initiator and mover of the CU. Russia seeks to counterbalance and stabilize alternative political (and economic) regional influences, particularly those of China. Balancing Chinese expansion is a key concern of Russia's import substitution-based modernization policy that is being promoted by the

² <http://www.research.by/pdf/pp2010r02.pdf>

Putin/Medvedev government (one of the most visible examples of this “modernization” drive was the closing of the famous Cherkizovo market in Moscow in 2009). Economically, Russia’s main goal is to rein in the autonomy (*samodeiatelnost* in Russian) of its neighboring states. Their independence in regional and global markets can be costly to Russia if they follow policies at odds with Russia’s own development plans. The relatively free trade regimes within Kazakhstan and Belarus have allowed importers to use them as transit points for bringing goods into Russia, thereby bypassing protective Russian tariffs. Such trade issues particularly underlined Belarusian-Russian relations. Since 1995, Belarus’ duty-free export trade to and from Russia were vital for building President Alexander Lukashenko’s shadowy business empire.

Russia seeks to stop the uncontrolled importation of a wide range of manufactured goods (including automobiles, clothing, and pharmaceuticals), which pose excessive competition to Russian companies and industries. By extending its internal market and better protecting its vital sectors, Russia makes itself more attractive for foreign investors aspiring to enter the markets of the CU member-states. While this can be technically true for all participants of the CU, studies have shown that it is the largest member of a custom union that benefits the most.

Another important consideration for Russia is the collection of import duties. Under the terms of the CU, these have to be divided according to a certain formula. Earlier on, Russia had to battle for its share of duties from Belarus, with which it shared a common customs territory. Russia is also interested in using the CU as an instrument to prevent the uncontrolled export of its raw materials through the territories of neighboring states (particularly Belarus).

Russia has a clear interest in receiving easier access to the markets of CU member states. The CU rules streamline the non-tariff limitations and revise agricultural subsidy rates. Belarus heavily subsidizes its collective farm sector, a practice that it may have to abandon soon. Importantly, leaving the average level of agricultural subsidies intact, Russia, through a redivision of “subsidy quotas,” may increase its own subsidies to agriculture before joining the World Trade Organization (WTO).

Belarus and Kazakhstan?

The advantages of the CU for Belarus and Kazakhstan are not as clear. Easy access to the vast Russian market, which economists of the Russian government have predicted will generate up to \$16 billion for Belarus and Kazakhstan over five years has already been enjoyed to a certain extent by the two states. Therefore, the benefit of joining the CU seems to be about “retaining” privileges and opportunities – continued access to the Russian market – but also, importantly, political goodwill and support from Russia on regional and global issues. One could say that with Russia’s move toward modernization, friendship has a higher price.

The tangible economic benefits for the two smaller states are primarily in the area of protecting goods produced in Belarus or Kazakhstan. For example, Belarusian producers of agricultural machinery and textiles may benefit from the application of

higher import duties on competitors' products. Another advantage is the application of national railway transportation rates that may actually invigorate trade between Kazakhstan and Belarus, particularly with regard to shipping Kazakh oil to Belarusian refineries, even though the Kremlin may not be happy at such a prospect and the oil will have to be declared as having Russian origin. Still, a more cost-stabilized and predictable transportation sector between the three countries could yield noteworthy gains.

Three-Month Assessment

The credibility of the CU was undermined almost immediately when its chief protagonist chose to frivolously observe its rules. While in the process of joining the CU, the Belarusian authorities hoped the pact would bring an end to the export duties levied by Russia on oil shipped to Belarus (since 2007, the levy has been at a rate of one-third the typical customs duty). Instead, Russia declared in early 2010 that the CU had nothing to do with oil exports and that full export duties would be levied on Belarus-bound oil, except for the one-third share of the total Belarus uses for internal consumption. This decision was seen in Belarus as the Kremlin's retaliation for Lukashenko's refusal to recognize the independence of Abkhazia and South Ossetia. Financially, it would have resulted in \$2 billion being transferred from Belarus to Russia (on the basis of previous oil import levels of about 20 billion tons a year). Thus, the Belarusian government decided not to ratify the Code of the Customs Union in the first half of 2010, opening a distinct prospect for derailing the CU by July 1, 2010, when trade barriers were to be eliminated. The Kremlin applied all kinds of political, economic, and information-campaign pressures against Lukashenko, even threatening that if Belarus did not sign up, Russia would install a customs regime along the Russian-Belarusian border. Russia's deputy prime minister, Igor Sechin, the person informally responsible for dealing with Belarus in the Kremlin, hinted that Russia would introduce customs duties on oil shipped to Belarus. Russia also demanded a small outstanding payment of about \$180 million for oil that had already been shipped to Belarus in the first half of 2010. Lukashenko refused to pay this bill on the pretext that the new export duties had not been properly negotiated and that the old agreements were still in force. This "oil war" ended with a large public relations embarrassment for the Kremlin when not only were oil shipments to Belarus suspended on June 22 – the day of the anniversary of Hitler's attack on the Soviet Union, a fact immediately used by Lukashenko's propaganda machine – but the Russian government "overlooked" an outstanding payment of \$220 million to Belarus for transiting oil through its territory, thereby making Russia a net debtor to Belarus as of June 2010.

Moreover, by spearheading the CU, the Kremlin accidentally violated a series of integration accords it had already signed with Belarus. Specifically, the Treaty on the Union State of Belarus and Russia, signed on December 8, 1999, specified that a joint customs space existed between the two countries with a mandate to unify all customs duties, fees, and procedures. As was the case with other integration accords in the former Soviet Union (like the Collective Security Treaty, which failed to bring any of the

allies to the rescue of Kyrgyzstan), the conflict between Belarus and Russia only highlighted the futility of such agreements. Russia also de facto sabotaged the workings of the Economic Court of the CIS when Belarus filed an official complaint about Russia and its method of levying customs duties on oil.

The prospect of Belarus opting out of the CU was, however, not an option. The Belarusian government could not risk any cessation of a free trade regime with Russia. Therefore, the Belarusian parliament, apparently on orders from Lukashenko, “secretly” ratified the Code of the Union at a closed-door session on July 6, 2010.

Expanding the CU and the Role of the WTO

The future of the CU will be determined by the Kremlin’s commitment to use it as a springboard for the reintegration of the former Soviet space. The idea that Ukraine should join the CU began to be debated right after the inauguration of its new president, Viktor Yanukovich. President Medvedev instructed the Federal Customs Service to “work out” the prospects for Ukraine joining the CU, a task which, experts believe, is not about economic expediency but a proper “political packaging” of the project.³ While Ukrainian officials have sharply denied any interest in joining the CU, there is a possibility that Russia will use the same tactics it used against Belarus, which is to use preferential pricing on energy as a carrot (or, alternatively, a stick). This trick of “friendship-enforcement” with regard to Ukraine (and Kyrgyzstan, which was also offered membership) will be more difficult because both countries are members of the WTO. This adds another reason for the widely advertised strategy of building CU regulations on the basis of WTO rules. This can have a positive effect on some of the member states as it may help them integrate into the global economy.

This notion could apply to Belarus, which, after all, once used an extensive system of non-tariff regulations to protect its internal markets, which developed to the extent that some Belarusian regions were protecting their markets from other Belarusian regions. Bringing CU regulations in line with those of the WTO may in fact promote competitive markets in Belarus, but only if this manages to correct the most obvious absurdities of Lukashenko’s “market-socialist” model.

Conclusion

We may expect the CU to develop as envisioned by Russia. The goal is to create a single economic space that unifies economic legislation and lays down the foundation for a common currency. The method will involve forcing countries into compliance on the condition that the benefits they already have will be left intact. Russia may induce Belarus to comply by promising to waive some export duties on oil, but it will most likely demand cessation of other concessions, such as lower customs duties for imported foreign cars.

As primarily a political project, the CU provides Russia with certain vetting rights on the other members’ geopolitical trajectories, counterbalancing the influences of

³ <http://www.gzt.ru/topnews/economics/-ukrainu-prorobotayut-po-voprosu-tamozhennogo-/291189.html>

external actors (the EU and China). As both Belarus and Kazakhstan strive to join the WTO (neither is likely to join before Russia does), they will have to balance their negotiations with WTO members against their obligations to the CU (the initial idea of joining the WTO as a three-member bloc was later dropped as totally unrealistic). For Belarus in particular, the CU effectively blocks the prospect of a deep, free-trade area under the aegis of the EU Eastern Partnership program. As far as economics is concerned, the costs and benefits remain to be seen, not least because porous borders leave both Belarus and Kazakhstan with ample opportunity to undermine regulations (some observers expect both to engage in the smuggling of goods that Russia is trying to protect). Ultimately, however, the CU is not so much about decreasing financial losses and boosting economic gains but creating a region of political cohesion and cooperation.

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