

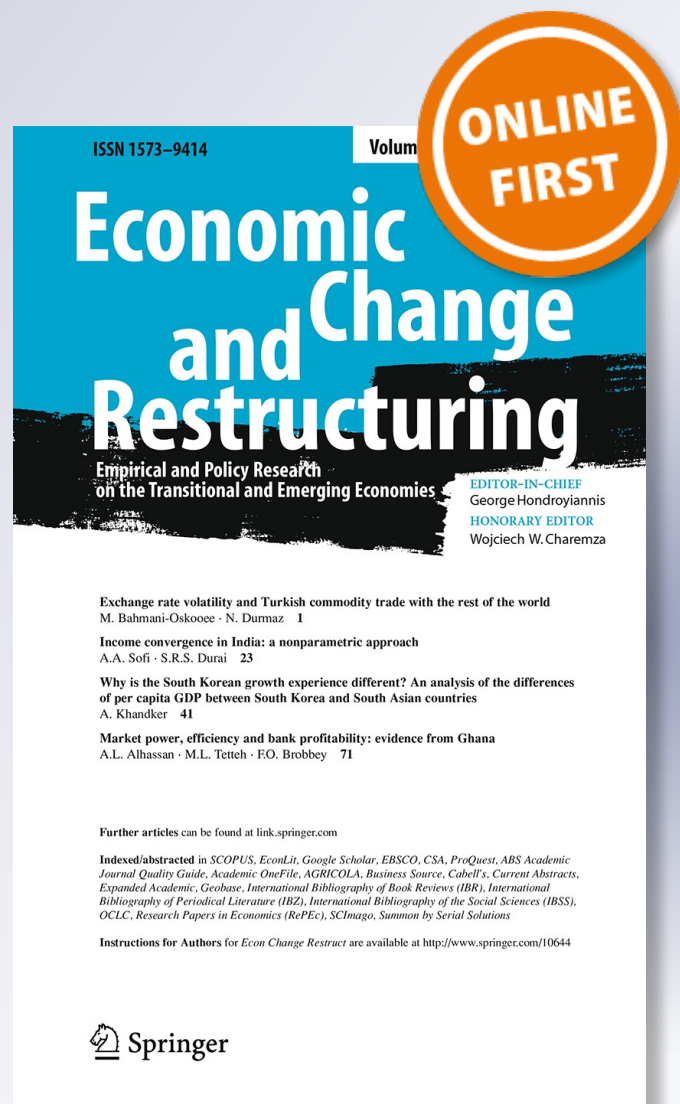
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Eurasian Economic Union: present and future perspectives

Azimzhan Khitakhunov¹ · Bulat Mukhamediyev² · Richard Pomfret^{3,4}

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Abstract This paper analyzes the economic and political situation in the Eurasian Economic Union. The basic question is why it was created after the failure of all previous integration projects in the Commonwealth of Independent States and Central Asian region? The paper examines the effects and opportunities for the regional economy of economic sanctions imposed on Russia and of Russian counter-sanctions. It also analyzes relations between the Eurasian Economic Union and the European Union and draws perspectives and policy implications for their future relations.

Keywords Eurasian Economic Union · Regional integration · Sanctions

JEL Classification F15 · F51 · O57

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1 Introduction

The formation of the Eurasian Economic Union (EAEU) has raised a large number of questions among economists and policy analysts. The EAEU is a classic customs union with internal free trade and a common external tariff. The model has been rare in recent decades, because some unions (e.g. the East African Community or the Central American Common Market broke down in acrimony due to trade diversion) and because many countries' tariffs are now sufficiently low that preferential treatment has little point (Pomfret 2001). There was also concern that regional blocs were a stumbling block rather than a building block towards global trade liberalization (Bhagwati 1992). In Sect. 2 we describe the EAEU and argue that it is sufficiently open to not be a trade-diverting threat to the multilateral trading system.

The real threat to the trading system has been the political tension between the EAEU and the European Union (EU). The EU is the largest trading partner of the EAEU, and some EAEU proponents saw the complementarity between the two regional organizations as offering an opportunity to create a free trade area from Vladivostok to Lisbon. However, opponents of the EAEU saw it as an anti-liberal bloc driven by political motives. Tensions between Russia and the EU were exacerbated by events in Ukraine in 2014. Section 3 analyzes this aspect of the formation of the EAEU.

A unique feature of the tensions was that the EAEU's common commercial policy was unhinged by unilateral actions with respect to Russia. Western sanctions on Russia as a consequence of the Ukraine political and military crises, and Russia's response embargo, meant that EU goods entered other EAEU members on different terms to entering Russia and Russian exports to the EU were treated differently to other EAEU members' exports to the EU. There was, of course, potential for trade deflection, as Russian consumers could source EU goods through other EAEU countries and, with false origin labels, Russian exporters could source EU markets via their EAEU partners. This phenomenon is addressed in Sect. 4.

Based on the intraregional economic and political relations and taking into consideration Russian political tensions with the EU, this paper aims to answer the following questions. Why was the EAEU created after the failure of all previous integration projects in the Commonwealth of Independent States (CIS) and Central Asian region? What were the relations between the EU and EAEU member countries in the pre-integration stage and what has changed? What are and could be the effects and consequences of sanctions involving Russia on the regional economy?¹ Section 5 draws future perspectives of EAEU and its relations with EU. The final section concludes.

2 What is the Eurasian Economic Union?

After independence, the former Soviet Union countries launched an integration process in the post-Soviet space. Creation of the CIS in 1991 had no economic impact on the participants, although it provided member countries with a civilized

¹ For review earlier literature on integration attempts see Pomfret (2009) and Laruelle and Peyrouse (2012); on EU-EAEU relations see Dabrowski (2008), Rotman and Veremeeva (2011) and Mukhamediyev and Khitakhunov (2015); and on sanctions see Elliot and Hufbauer (1999).

divorce. In the first half of the 1990s several regional organizations were created in Central Asia: Central Asian Economic Cooperation, created in 1994, was transformed in 2002 into the Central Asian Cooperation Organization (CACO), which in 2005 merged with Eurasian Economic Cooperation (EurAsEC).² In 2007 President Nursultan Nazarbayev of Kazakhstan initiated the idea of Central Asian Union, but it was rejected by Turkmenistan and Uzbekistan. Finally, the “noodle bowl” of agreements (UNDP 2005) was untangled by formation of a customs union between Belarus, Kazakhstan and Russia in 2010 on the base of EurAsEC. In 2012 the three countries transformed the customs union into a Single Economic Space. In May 2014 they signed the Agreement on EAEU formation, which came into force on January 1, 2015. The membership of Armenia and the Kyrgyz Republic became effective in 2015. Table 1 summarizes the steps towards the EAEU since 2000.

Thus, EAEU is an international organization for regional economic integration with international legal personality, established by the Treaty on the EAEU. It provides free movement of goods, services, capital and labor, pursues coordinated, harmonized and single policy in the sectors determined by the Treaty and international agreements within the Union. It is governed by the Supreme Eurasian Economic Council, which includes the presidents of member countries, the Eurasian Intergovernmental Economic Council which consists of member countries' prime ministers, the Eurasian Economic Commission, and the Court of the EAEU.

Besides free factor movements and economic policy harmonization, other reasons for the formation of the EAEU include close economic relations, political and social reasons. The EAEU is not a group of unrelated countries willing to form a customs union, but due to its Soviet history all members were part of single economic entity. This fact characterizes the extremely high economic interdependence between the participant countries, which in a lesser but still important level remained after dissolution of the Soviet Union. Social interactions are also important: common language, common history and similar institutions make economic integration easier.³ Political and strategic motivations are generally as strong or stronger than the economic aspects. The emerging countries, in this case Russia and the transitional economies, are increasingly looking for horizontal alliances and are interested in promoting new regional trade agreements (RTAs), as changes in political balance and alliances at the world level, between developed and

² President Nazarbayev voiced the idea of the Eurasian Union of States for the first time at Lomonosov Moscow State University, during his first official visit to Russia on March 29, 1994. In June 1994, a detailed integration project was submitted to the Heads of the States and then published in the press; for the first time, the integration alliance was called “the Eurasian Union” in an official document. In 1995 Belarus, Kazakhstan and Russia signed the Treaty on the Customs Union. The Treaty signed by the three states created the integration nucleus that now drives integration in the Eurasian region. In 1996 with the participation of Kyrgyz Republic they signed the Treaty on Deepening Economic and Humanitarian Integration in Moscow. Tajikistan joined the Treaty in 1998. In 1999 the presidents of five countries signed the Treaty on the Customs Union and Single Economic Space in Moscow.

³ According to a large-scale survey published by the Eurasian Development Bank (EDB 2015a), the formation of the customs union was supported by 80 % of the respondents in Kazakhstan, 78 % in Russia, 60 % in Belarus and 56 % in Armenia. These results could be explained by Soviet nostalgia (mainly in economic turmoil periods), social ties such as existence of relatives and friends in other countries, and common media based on Russian language (Libman and Vinokurov 2014, p. 344).

Table 1 History of Eurasian Economic Union

Year	Country	Event
2000	Belarus, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan	The presidents established the Eurasian Economic Community in Astana to promote efficiently the formation of the Customs Union and Single Economic Space
2003	Belarus, Kazakhstan, Russia, Ukraine	Treaty on Establishment of the Single Economic Space signed in Yalta
2006	Belarus, Kazakhstan, Kyrgyz Republic, Russia, Tajikistan	During an informal summit in Sochi, the Heads of the Eurasian Economic Community Member-States decided to intensify their work to create a customs union among three member states, with subsequent accession by the Kyrgyz Republic and Tajikistan as soon as their economies were ready
2007	Belarus, Kazakhstan, Russia	The Treaty on the Creation of the Single Customs Territory and Establishment of the Customs Union was signed in Dushanbe
2010	Belarus, Kazakhstan, Russia	The Customs Union was launched: the Common Customs Tariff was implemented, customs formalities and customs control at the internal borders were cancelled, and free movement of goods within the three states was ensured The Declaration on Establishment of the Single Economic Space of the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation was signed
2011	Belarus, Kazakhstan, Russia	The Presidents of the integrating three States signed the Declaration on Eurasian Economic Integration. The Heads of the Customs Union member states also signed the Treaty on the Eurasian Economic Commission In October 2011, a decision was taken to start negotiations on the accession of the Kyrgyz Republic to the Customs Union The Supreme Eurasian Economic Council at the level of the Heads of States took the Decision on the Enactment of the Treaties Establishing the Single Economic Space effective January 1, 2012
2012	Belarus, Kazakhstan, Russia	The treaties entered into force. The Eurasian Economic Commission, headquartered in Moscow, started its work in February
2014	Belarus, Kazakhstan, Russia, Armenia, Kyrgyz Republic	The Presidents of the customs union and Single Economic Space member states signed the Treaty on the Eurasian Economic Union at the session of the Supreme Eurasian Economic Council. On October 10 the Agreement on Accession of the Republic of Armenia to the EAEU was signed in Minsk. On December 23 in Moscow, signed the Agreement on Accession of the Kyrgyz Republic to the EAEU

Source: EAEU website www.eaunion.org

developing countries, are being heavily influenced by the RTA trend (Benini and Plummer 2008). In addition, customs union creation is explained by Russia's desire to control and reduce the economic dominance of China in the region, which from low levels before 2000 had become the biggest trade partner of Central Asian states

by 2009 (Kim and Blank 2013). Kazakhstan is driven by its economic ambitions to be in the list of the 30 most developed and industrialized world economies to 2050 and is interested in market expansion and liberalization through increasing competition. In addition to the reasons mentioned above, regionalism also could be driven by crises (Libman and Vinokurov 2014).

The EAEU is a grouping of semi-industrialized countries with different levels of economic development (Table 2) and economic structure (Table 3). The most developed members with their huge stock of natural resources, Kazakhstan and Russia, benefited much from the increase in oil prices after 2000 and, as a consequence, improved social well-being. Thus, while nominal per capita GDP of Kazakhstan and Russia is higher than the world level, for Armenia, Belarus and Kyrgyz Republic this indicator is much less than world level and respectively equal to 74.1, 34.5 and 11.6 % (Table 2). The rise of services was accompanied by the simultaneous decline of agriculture's share in GDP in Kazakhstan and Russia.

Belarus is the most industrialized EAEU member with the highest level of manufacturing but it has had several economic crises since independence and is dependent on Russian credits and investment. Resource-poor Armenia and Kyrgyz Republic, both with the highest share of agriculture in GDP, are two underdeveloped countries and became the sources (as Tajikistan and Uzbekistan) of large-scale international migration to Russia. Furthermore, Armenia was involved in bloody conflict with Azerbaijan, which is still unresolved. Kyrgyz Republic had two revolutions in 2005 and 2010 when presidents were deposed. In 2010 the political turbulence led to ethnic conflict in the south regions of the Kyrgyz Republic. The national economies of both latter countries were negatively affected by regional conflicts and political tensions and the dependence on their richer partners through migrant remittances increased significantly. For all of these reasons, despite the similar initial conditions, there has been income divergence in the region.

The EAEU common external tariffs are mainly Russian tariffs, which had little impact on Belarus and significantly increased Kazakhstan's tariffs. Russia left unchanged 82 % of its customs tariffs, lowered 14 % and increased 4 %s of its tariffs. The corresponding shares for Kazakhstan were 45, 10 and 45 %. In 2009, the simple average MFN applied tariffs for Belarus, Kazakhstan and Russia were equal to 10.6, 5.9 and 10.5 % respectively (WTO 2010). As a result of the CET implementation the tariffs of Kazakhstan have increased from an average of 6.7 to 11.1 % on an unweighted basis and from 5.3 to 9.5 % on a trade-weighted basis (World Bank 2012). Estimates of the customs union's effects are ambiguous,⁴ but it had a significant impact on intraregional trade (Table 4).

Exports from Kazakhstan to Russia decreased significantly since 2000, and exports from Kazakhstan to Belarus are comparatively small (Table 4). Export from Russia to Kazakhstan had a decreasing trend, and as the result of world economic crises export/GDP ratio fell to a low of 0.36 % of GDP in 2010. As a result of customs union implementation, these ratios approximately doubled by 2011 for all countries. Why did the export/GDP ratio of Kazakhstan decrease after 2011 while

⁴ See, for example, Mogilevskii (2012) and Laruelle and Peyrouse (2012), the Eurasian Development Bank (EDB 2013, 2015b).

Table 2 Selected socio-economic indicators of CIS and EAEU countries, 2013

	Nominal GDP, million USD	Nominal GDP per capita, USD	Real GDP, million USD (2005 = 100)	Real GDP per capita, USD (2005 = 100)	Population ^a , million
CIS	2,819,222.0 (3.80 %)	10,152.9 (97.50 %)	1,337,162.0 (2.40 %)	4815.5 (61.60 %)	274.6
EAEU	2,454,361.0 (3.30 %)	13,757.6 (132.06 %)	1,146,140.0 (2.05 %)	6424.6 (82.16 %)	178.4
Armenia	10,708.6 (0.01 %)	3597.6 (34.53 %)	7005.6 (0.01 %)	2353.6 (30.10 %)	3.0
Belarus	72,226.8 (0.10 %)	7719.3 (74.10 %)	46,979.1 (0.08 %)	5020.9 (64.21 %)	9.5
Kazakhstan	220,550.4 (0.30 %)	13,415.0 (128.77 %)	93,148.2 (0.17 %)	5665.8 (72.45 %)	16.9
Kyrgyz Republic	6729.2 (0.01 %)	1212.9 (11.64 %)	3,369.6 (0.01 %)	607.4 (7.77 %)	5.7
Russia	2,144,146.0 (2.87 %)	15,011.5 (144.09 %)	995,637.7 (1.78 %)	6970.6 (89.14 %)	143.3

Source: Authors' calculations based on UNCTAD statistics

Percentages in brackets show the ratio of each country's indicator to the world level

^a Population data from CIS statistical committee

Table 3 Economic structure of EAEU countries, 2013, per cent share of GDP

	Agriculture	Industry (Manufacturing)	Services
Armenia	21.94	31.48	46.58
Belarus	9.11	42.24	48.65
Kazakhstan	4.94	37.84	57.22
Kyrgyzstan	19.73	25.38	54.89
Russia	3.94	36.16	59.90

Source: World Bank World Development indicators

Table 4 Bilateral export/GDP ratio for EAEU members, 2000–2013, per cent

	Kazakhstan–Russia	Kazakhstan–Belarus	Russia–Kazakhstan	Belarus–Kazakhstan
2000	9.35	0.09	0.90	0.31
2001	7.82	0.02	0.90	0.38
2002	6.08	0.05	0.74	0.38
2003	6.38	0.04	0.76	0.53
2004	6.57	0.04	0.81	0.62
2005	5.12	0.05	0.86	0.69
2006	4.60	0.09	0.92	0.77
2007	4.44	0.12	0.89	0.87
2008	4.67	0.13	0.83	0.65
2009	3.08	0.05	0.73	0.75
2010	2.03	0.03	0.36	0.45
2011	4.00	0.06	0.85	1.04
2012	3.32	0.04	0.85	1.06
2013	2.59	0.03	0.84	0.95

Source: Authors' calculations based on UN Comtrade data and World Bank World Development indicators

The first country in each country-pair is exporter. The ratio is calculated as export to GDP of exporter

Belarus and Russia retained their shares in Kazakhstan's market? This could be explained by commodity composition of trade in the EAEU and Kazakhstan's economic structure. Even at the regional level, Kazakhstan remains a raw materials supplier (Table 5), and the low level of agriculture and manufacturing output restricts Kazakhstan's export to other EAEU countries. The poor manufacturing could be explained by at least two reasons. Firstly, Kazakhstan benefited much from the increasing oil prices since 2000 and mostly emphasized the development of its financial market and, despite the accepted programs, paid little attention to agriculture or manufacturing. Secondly, Chinese products are more competitive due to the costs of production. Hence, the transition period's feature is the transformation of local producers into mediators of imported goods from China, Turkey and Europe. Russia is also a raw materials supplier but has a higher level of manufacturing than Kazakhstan. High level of industrialization and economic

Table 5 Structure of mutual trade of CU members 2013, percentage of total

Section	Belarus	Kazakhstan	Russia
Live animals	19.09	0.50	1.14
Vegetable products	1.80	6.32	0.65
Prepared foodstuffs	6.37	1.24	4.77
Mineral products	6.57	40.85	43.36
Products of the chemical and related industries	2.97	7.31	5.45
Plastics and articles thereof; rubber and articles thereof	7.76	0.83	4.47
Wood and articles of wood	1.43	0.01	0.97
Textiles and textile products	5.81	1.32	1.45
Stone, plaster, cement, etc. articles; ceramic products; glass and glassware	3.13	0.26	1.72
Base metals and articles thereof	7.40	24.17	13.62
Machinery; electrical and electronic equipment	14.03	7.99	10.61
Vehicles, aircrafts, floating crafts and related transport equipment	15.83	2.21	5.79
Miscellaneous manufactured articles	3.36	0.13	1.26
Others	4.45	6.86	4.74

Source: Eurasian Economic Commission (2014)

Table 6 EAEU countries WTO status to December, 2015

	Applied	Member
Armenia	November 1993	5 February 2003
Belarus	September 1993	ongoing negotiations
Kazakhstan	January 1996	30 November 2015
Kyrgyz Republic	February 1996	20 December 1998
Russia	June 1993	22 August 2012

Source: WTO website www.wto.org

diversification make Belarus more competitive within the EAEU, and as a consequence Belarus significantly increased its export to partner countries' markets.

The last important question to be answered in this section is whether the EAEU is a trade diverting threat to the world trade system? All EAEU members except Belarus are WTO members (Table 6). Thus, the EAEU is outward-looking integration seeking to facilitate intraregional economic relations with simultaneous integration into the world trade and economy.

Despite the outward-orientation of the EAEU, there are potential conflicts for Armenia and Kyrgyz Republic with their WTO commitments. The simple average MFN applied tariffs for Armenia and the Kyrgyz Republic in 2013 were 3.5 and 4.6 % respectively (WTO 2014). Thus, tariffs of both countries will be increased significantly as they adopt the EAEU common tariff, which could lead to trade diversion and could be the case for compensation within their WTO obligations. For instance, 30 % of Kyrgyz duties align with those of the customs union, 21 % can be realigned without violating WTO commitments, and 49 % would require

renegotiation of WTO terms (and potentially compensation to affected WTO members) before they could be aligned (WTO 2013, p. 25). To reduce the risk of trade diversion, Armenia and Kyrgyz Republic secured transition periods. Armenia will have transitional tariffs for some commodities from 1 to 8 years, while transition period for Kyrgyz Republic will last from 5 to 10 years. Nevertheless, imports into Kyrgyz Republic are expected to decline by 0.6 % during the transition period and by 1.4 % after the transition period (IMF 2015a, p. 8).

However, the common external tariff rate schedule of the EAEU will decline over the medium term, reducing risks of trade diversion after the end of transition periods. The analysis on Kazakhstan suggests little trade creation and some trade diversion as a result of tariff change. While overall imports for a particular product line appear to be broadly unaffected, an increase in tariff had a negative impact on imports from China and a significantly positive impact on imports from the customs union partners. Moreover, there is little evidence that the effect extends to exporters with a higher share of higher-value-added goods in their product mix, such as the EU countries (Isakova and Plekhanov 2012). Kazakhstan's recent WTO accession with lower tariffs than the EAEU tariff line for a variety of products (approximately 3000) complicates trading within the customs union. To resolve contentious issues the EAEU members adopted a special document entitled "On some issues related to the accession of Kazakhstan to the World Trade Organization". Thus, Kazakhstan reduced the risk of trade diversion by prioritization of its WTO obligations. The customs union will not lead to trade diversion for Russia as CET are mainly Russian tariffs that were initially identical with tariffs of Belarus. When Russia joined the WTO in 2012 its commitments included substantial tariff reductions (to an average tariff of 8 % by 2020), elimination of some non-tariff barriers to trade, and written clarification of other nontariff measures that affect trade. All of these policies will be implemented as changes in the EAEU's common external commercial policy. With the 2020 external trade policies, the customs union is likely to be less harmful for members with initial low tariffs, mainly for Armenia and Kyrgyz Republic.

Thus, the important point here is that the EAEU as an example of regionalism is not a stumbling block and threat to global trade system; the real threat to the world trade system is political tension, which will be discussed in following section.

3 Implications for EU–EAEU relations

The EAEU is a comparatively small part of the world economy. The world share of its nominal GDP was 3.3 % in 2013 (Table 2), and the regional economy has declined since 2012 due to the slowdown of Russian economy. After the "Crimea Spring" and political and military crises in Ukraine and as a consequence of sanctions imposed on Russia and Russian response with an embargo on European agriculture producers, and the significant reduction of oil prices, economic growth of EAEU countries declined.

The crisis in Ukraine had significant implications for Eurasian regionalism. Firstly, Belarus, Kazakhstan and other countries of the region had to reevaluate Russian actions and behavior, as one of the key elements of Eurasian regionalism

has been mutual recognition of the territorial integrity of participating countries. The Ukrainian crisis became a reason for concern for the neighbors of Russia. Kazakhstan has followed a principle that the EAEU must be purely economic and free from politics. Secondly, the Ukrainian crisis created substantial problems for purely economic cooperation. Due to economic sanctions it became substantially difficult to develop economic ties to Russia and at the same time to attract foreign partners. A more serious risk is associated with unilateral actions of Russia which imposed countersanctions on the EU and the USA. Belarus and Kazakhstan refused to support Russia's countersanctions to avoid the escalation of the conflict and for purely economic reasons. Russia implemented the restrictions unilaterally, which are serious violation of the spirit of the CU. Thirdly, under the current circumstances, Russia is more interested in preserving the EAEU for its symbolic importance: the existence of the EAEU is perceived by the Russian leadership as a sign of Russian importance in international relations and as an indication that the effort of the West to isolate Russia internationally does not succeed. Therefore, Russia is likely to be more willing to make further concessions to the EAEU countries to keep them in the Union.⁵

While in most parts of the world the EU has promoted regionalism, in Eurasia the EU did not demonstrate any interest in dialogue with the regional organizations. But the Ukrainian crisis changed this attitude. From 2015, the issue of negotiations between the EU and the EAEU became a frequent topic of discussion in the European politics. This could be explained by at least two reasons: first, some believe it to be a suitable reward for the Russian leadership to change its attitude towards Ukraine; second, EU–EAEU engagement could give a new forum to continue economic dialogue with Russia even under difficult circumstances. This dialogue could be important and fruitful as countries like Kazakhstan and Belarus have a clear interest towards finding a reasonable way to sustain economic relations between Eurasia and Europe, and they try to promote a cooperative approach (Libman 2015). As the importance of the EU for the EAEU's development as the biggest trade and investment partner is significant, there is a need to investigate the separate relations of EAEU member countries with the EU at the pre-integration stage because these relations were rather contradictory; for instance, contrast EU–Belarus political tensions with Armenia's participation in the European Neighbourhood Policy and Eastern Partnership Program.

Initially, cooperation between the EU-15 and the CIS was built on the basis of bilateral partnership and cooperation agreements (PCAs) negotiated during the

⁵ Belarus is interested in obtaining Russian crude oil for its oil refineries and exports their production to Europe. Russia imposes export duties on crude oil for protection of its own oil refineries. Belarus considered the abolition of these duties or the redistribution of the revenue from the duties as a precondition for any further integration steps. This issue played a major role when the customs union was initiated in 2010. In 2014, Belarus again put similar request, threatening not to sign the EAEU treaty in May if its conditions were not fulfilled. The result of these negotiations has been a new settlement, giving Belarus substantial access to the revenue from oil duties. Kazakhstan blocked the inclusion of any political aspects in the EAEU treaty: even relatively symbolic institutions typically existing in most international organizations like an inter-parliamentary assembly were not established within the EAEU due to a firm position of Kazakhstan (Libman 2015).

1990s. Nine of these entered in force between 1997 and 1999. Several Programs were funded by the EU to support the newly independent countries, e.g. Technical Assistance to the Commonwealth of Independent States (TACIS), the Transport Corridor Europe-Caucasus-Asia (TRACECA), and the Interstate Oil and Gas Transportation to Europe (INOGATE).

During the first years of its sovereignty, Belarus's relations with the EU were rather promising but these progressive trends in the EU–Belarus relationship were interrupted after the Belarusian referendum of 1996, which was declared undemocratic and a violation of human rights. During 1996–2006 due to economic sanctions Belarus was internationally isolated. The European mass media termed this period as Belarus's 'self-isolation', but the sanctions pushed the new state towards rapprochement with Russia and other CIS countries to help the country to survive and develop; not simply did the national authorities prove capable of sustaining themselves, but also the country's people became quite sceptical in assessing the prospects of Belarus's integration with the EU. Since early 2007, Belarus has undertaken a number of significant political steps to facilitate new relations with the EU, and the EU has also taken some friendly steps towards Belarus. The European Parliament passed a resolution concerning the situation in Belarus on 15 January 2009, in which it formally acknowledged positive trends in the development of democracy in the country. In 2008 an office for the EU Delegation in Belarus was opened which became another important milestone in EU–Belarus bilateral relations. A number of crucial meetings with European officials took place during 2008–2009. Belarus was accepted into the Eastern Partnership initiative on 9 May 2009 (Rotman and Veremeeva 2011). After the Ukraine ceasefire agreed in Minsk in February 2015, EU–Belarus relations promised to change positively.

Bilateral relations of the EU with Armenia, Kazakhstan and Kyrgyz Republic started in 1999 with PCAs based on political, economic and institutional cooperation. In 2004 the EU demonstrated willingness for deeper cooperation with Armenia and included it in the European Neighbourhood Policy and Eastern Partnership Program. Despite the finalization of an Association Agreement, including a Deep and Comprehensive Free Trade Area (DCFTA) in July 2013, in September 2013 Armenia announced its intention to join the customs union of Russia, Belarus and Kazakhstan. Hence, the Association Agreement will neither be signed nor implemented. For Armenia, national security became the key issue for why it joined the EAEU.⁶ Despite membership in the EAEU, Armenia continues to participate in EU programmes such as new visa facilitation and readmission agreements.

⁶ The Nagorno-Karabakh conflict keeps Azerbaijan and Armenia in a state of *de jure* war and challenges regional security. The EU had to keep neutrality over the conflict due to its interest on cooperation both with Armenia and Azerbaijan. Since Azerbaijan, Turkey and Georgia have taken steps to strengthen political, economic and security cooperation, Armenia has become further isolated and more dependent on Russia (Paul 2015). Negotiations were conducted between Armenian and Russian presidents on the basis of trade-offs between Moscow's desire to see Armenia join the EAEU and Yerevan's demand for security guarantees from Moscow (Cadier 2014, p. 80).

Cooperation between the EU and Central Asian countries as Kazakhstan and Kyrgyz Republic are mainly based on the PCA of 1999 and the EU's 2007 Strategy for a new Partnership with Central Asia. In 2014 the EU and Kazakhstan successfully concluded negotiation of the EU–Kazakhstan Enhanced PCA. This is an important moment both for the EU and Kazakhstan, as the new Agreement will deepen political and economic ties between the two sides. Kazakhstan is the first Central Asian partner to have concluded an Enhanced PCA with the EU. The new Agreement will replace the PCA in force since 1999, and will give EU–Kazakhstan relations a new up-to-date and stronger foundation (Mukhamediyev and Khitakhunov 2015). For the Kyrgyz Republic, the EU has provided technical and financial support through its Development Cooperation Instrument and is currently working on a new programme for 2014–2020.

Thus, cooperation with the EU is in high interest of all EAEU members. Hence, EAEU membership and cooperation with the EU are complementary and give an opportunity for further interregional integration, when relations between the western countries and Russia will be normalized. Moreover, the EU–EAEU dialogue would increase the value of the EAEU for the member countries and, in particular, for Russia and would to some extent strengthen the perspectives of regional integration in Eurasia (Libman 2015).

4 Sanctions in customs union

Sanctions as a unilateral or collective action against a state considered to be violating international law are typically initiated by powers that are politically, economically and militarily much stronger than the targeted nation. In the 115 cases of economic sanctions deployed since 1914 the sanctions sender's GNP was always over ten times and in the majority of cases more than 50 times greater than that of the target. When "modest policy changes" and "destabilization" of the government were the goal, the sender's economy was on average more than 200 and 400 times respectively larger than the target's economy. Sanctions which have greatest impact are composed of various restrictions on international trade, financial flows or the movement of people. However, in recent decades, economic sanctions have been pursued for a much broader range of international goals: hastening the achievement of freedom and democracy, strengthening human rights or labor rights, nuclear nonproliferation, etc. Thus, sanctions are meant to influence the behavior of foreign nations, now or in the future, by providing current constraints or promising them for the future and may also serve some role in meeting domestic political concerns (Davis and Engerman 2003). Types of economic sanctions are different: sanctions that limit exports and that restrict imports; sanctions that impede finance; strategic and tactical sanctions. While strategic sanctions aim to undermine key security interests of the target country, tactical sanctions, on the other hand, are ones in which the sender is seeking economic benefits, with no attempt to undermine the target's security interests or to change its domestic political structure (Zhao 2010, p. 266).

The success of sanctions mainly depends on two factors: first, it is higher when more nations are involved in imposing the sanctions; and second, the greater the income disparity between the nation imposing sanctions and the target, the greater the chance of success. The implementation of sanctions is costly both for the sanction sending and for the targeted nation. In most cases, the economic costs imposed on the target countries by sanctions have been negligible, but in a significant proportion of cases the impact has been substantial.⁷ The effects of sanctions on third countries are ambiguous; sanctions may have a negative impact on third countries' trade, but whenever sanctions are unilaterally imposed the impact could be circumvented by diverting trade through third countries (i.e. sanctions-busting, Yang et al. 2009, p. 1225). Third countries may capture the gains of diverted trade, and the effectiveness of sanctions is then highly questionable.

Before the Ukraine crises, EU–Russia relations were highly cooperative. Russia proposed energy, visa-facilitation, foreign policy and security cooperation (Lavrov 2013, p. 11). Since the “Crimea Spring” there is a high tension between the US–EU coalition and the EAEU's biggest economy Russia. The USA and EU imposed sanctions on Russia because of the political and military crises in Ukraine, and Russia responded by its own embargo on agricultural products from sanction-sending countries. Sanctions and crises came simultaneously with the creation of the EAEU.

The slowdown of the Russian economy began in 2012. Since 2014 Russian economy is being highly impacted by two external shocks: the oil price shock and sanctions of western countries. As a consequence, real GDP growth slowed from 1.3 % in 2013 to 0.6 % in 2014. The Russian currency came under severe pressures at the end of 2014 due to the intensification of sanctions. As a result, inflation accelerated sharply. In response, the shift to a flexible exchange rate was accelerated. Capital outflow reached 130.5 billion dollars in 2014, compared to 61 billion dollars in 2013. Total FDI into Russia in the first three quarters of 2014 was 47 % lower than the average for the same quarters in 2011–2013. Thus, economic growth of Russia is hardly possible in medium-term and totally dependent

⁷ Limited sanctions were found to reduce bilateral two-way merchandise trade by an average of 27 %, the reduction from moderate sanctions was 36 %, and severe sanctions diminished bilateral trade flows by an average of 91 % (Elliot and Hufbauer 1999, p. 406). The cost of the United Nations and the US sanctions versus Iraq has been estimated at 48 % of Iraq's GNP, with a particularly heavy burden on the incomes and mortality of the poorer segment of the population. The 1980 US embargo on grain exports to the Soviet Union was the classic case of economic sanctions gone awry. The embargo did raise the price of grain to the Russians by an estimated \$225 million, but the Soviets were able to turn to other sources, and the price increases did not dissuade them from their Afghanistan adventure. The direct cost of the sanctions to the United States has been estimated at \$2.3 billion, but the total costs were arguably much higher. American farmers lost their dominant market share in grain imports to the USSR, and due in part to Russian fears of becoming dependent on producers subject to the political whims of the US government, they have never recaptured that position (Davis and Engerman 2003). Trade sanctions' impact on Iran's non-oil exports and capital goods imports have been significant compared to their effect on Iran's oil exports. The financial sanctions' impact on Iran has been greater than that of the trade sanctions as they have curtailed Iran's ability to borrow funds and to finance its oil development projects and Iran has paid higher rates of interest on its loans and has guaranteed excessively high rates of return on investment on its oil buyback projects. Torbat (2005, p. 432) estimated the trade and financial sanctions' cost to Iran to be about 1.1 % of Iran's GDP.

on external factors.⁸ This puts additional pressure on Russian EAEU partners and the whole CIS region due to high economic interdependence. For Armenia and Belarus, Russia is the biggest export partner and source of investment.

Kazakhstan as the raw materials supplier is also negatively affected by oil price shocks and is experiencing slower economic growth in 2014. The reasons for decline are lower oil production and weaker demand by China and Russia for Kazakhstan metal products. Economic decline of Russia negatively affects Kazakhstan through trade and investment channels. Kazakhstan's exports decreased, as did investment flows from Russia to Kazakhstan. The World Bank (2014) estimated that Russian anemic economic growth was shaving 0.5–1 % points from Kazakhstan's GDP growth in 2014 because it negatively affected domestic and international sentiments about investing in Kazakhstan. Finally in 2015, Kazakhstan moved to floating exchange rate regime, with significant loss of the value of its currency, and for domestic demand stimulation the Government tapped the National Fund and launched an economic support program of 5.5 billion dollars. As a consequence of external pressure, Kazakhstan cut 10 % of its budget for 2015.

There is also an important problem of regional security connected with migrants from Central Asia to Russia. Russia is the major destination for migrants from CIS countries. Because of ruble crises, migration became unprofitable, migrants had to return home, and remittances in 2014 were negatively impacted by ruble depreciation. Of total US \$20.2 billion remittances from Russia, more than 88 % went to Uzbekistan (\$5.6 billion), Tajikistan (\$3.7 billion), Ukraine (\$2.2 billion), Kyrgyzstan (\$1.9 billion), and Armenia (\$1.2 billion). However, in 2014, the currency depreciation meant that the value of remittances to these countries was 14 % less than in 2013. During the fourth quarter of 2014 (year-on-year) outward remittances from Russia declined by 33 %: remittances in US dollar terms, falling by 51 % to Ukraine, 43 % to Uzbekistan, 31 % to Armenia, and 27 % to Tajikistan (World Bank 2015b). Kazakhstan is the second destination for migrants from elsewhere in Central Asia. It is estimated that migrant workers in the country, both regular and irregular, may number more than one million. If transfers from Russia and Kazakhstan decline, taking into consideration poor economies of Central Asia and high rate of unemployment, those remittances are vital for families and for their economies, and there is a risk for regional instability.

There is an opportunity for Russian EAEU partners to benefit from Russia's embargo on European agriculture producers by expanding their export of targeted items. As Belarus and Kazakhstan refused to join the sanctions against western countries, Russia resorted to unilateral actions disregarding legal issues with respect to its customs union partners (Dragneva-Lewers and Wolczuk 2015). European agriculture producers can export banned goods to Russia through the customs union

⁸ The World Bank (2015a) draws three medium-term scenarios for Russian economy, which will be mainly dependent on oil prices. If oil prices are in the US\$53–57 per barrel interval (baseline scenario), Russia's GDP growth will be –3.8 and –0.3 % in 2015 and 2016 respectively. If oil prices achieve US\$66–69 per barrel (upper-bound oil price scenario), the GDP growth will be –2.9 and 0.1 %, and if oil prices are equal to US\$45–50 per barrel (lower-bound oil price scenario) Russia's growth will be –4.6 and –1 % in these years.

partners and Russian producers can export their products in the same way.⁹ Thus, this is one of the experiences when sanctions are indirectly being imposed on a regional economic organization (the EAEU), but customs union membership creates export opportunities for producers in both the sanctions-sending coalition and the targeted nation.

IMF (2015b) estimated that sanctions and counter-sanctions could initially reduce real GDP by 1–1.5 %. The impact of prolonged sanctions will be more harmful as they could lead to a cumulative output loss over the medium term of up to 9 % of GDP, as lower capital accumulation and technological transfers weakens already declining productivity growth.

Thus, based on the above analysis, two scenarios can be distinguished: (1) the best-case scenario, when sanctions will be cancelled, all economic relations will be normalized and in the long term Russia will reduce its tariff rates according to its WTO obligations, and after the Belarus' WTO accession the EAEU will freely trade with the rest of the world, and (2) the worst case scenario, when Russia to avoid balance of payment crises may impose more restrictions on EU producers, which will lead to more contradictions, decline of Russia and EAEU, and as a consequence instability in Russia and Central Asia.

5 Future perspectives

Future cooperation between EU and EAEU is inevitable and will cover both economic (trade and energy) and political (security) issues. Energy relations between EU and EAEU have high importance; in the list of main energy trading partners of the EU, Russia is in the first place, while Kazakhstan is in the fifth (Pongas et al. 2014). Russia provides the EU with a third of its oil and natural gas and almost a quarter of its coal and petrochemicals. For further energy cooperation until 2050 the road map between EU and Russia was signed on March 2013 (Lavrov 2013 pp. 7–8). Many papers are dedicated to the issue of EU–Russia energy relations.¹⁰ The EU is the biggest trade and investment partner of the EAEU, and the source of new technologies and innovations, institutional reforms and democratic changes. The normalization of EU–EAEU relations is strongly supported by EAEU society as the westernization of preferences and demand for European education and science standards are high.

The political role of Russia is more important than the economic. Russia plays one of the leading roles for the solution of political and military crises in Ukraine, Middle East and Islamic State, and Russia and Kazakhstan play a significant role in keeping Central Asia stable. The EU is open to region-to-region trade agreements as

⁹ Introduction of sanctions led to a massive increase of smuggling activity from the EU to Russia, using Belarus' entry points. To limit these informal imports, Russia re-introduced checks at the Belarus border which caused dissatisfaction of Belarus and it responded with introducing its own restrictive measures, de-facto restoring customs control at the joint border and even blocking transit goods from Kaliningrad enclave to Russia.

¹⁰ For example, Van Der Meulen (2009), Schmidt-Felzmann (2011), Fernandez (2011), Cwiek-Carpowicz (2012) and Kratochvil and Tichy (2013).

with ASEAN or Mercosur, and the German Chancellor Angela Merkel has mentioned about talks between EU and EAEU on trade issues potentially leading to an inter-bloc FTA and common economic space from Lisbon to Vladivostok. Thus, a step-by-step approach with EAEU is highly justified and any dialogue must include the Eurasian Economic Commission and other EAEU members, to prevent Russia from monopolising the EAEU's external agenda (Dragneva-Lewers and Wolczuk 2015). Therefore, there is a need for a new separate bilateral PCA between EU and EAEU, which will lead to a trade agreement and might resolve a big number of conflict issues (Mukhamediyev and Khitakhunov 2015).

Since the creation of the EAEU, debates on its future expansion took place. The willingness of enlargement of a union is dependent on its internal features: if it is truly open, the enlargement process stops only if some outside countries have high resistance to membership; if it is not entirely open, the process will stop when the member countries refuse to admit an outsider whose membership would be very costly (economically or politically); if the bloc is entirely closed, membership requests will pile up, and the outsiders may turn elsewhere (Baldwin 1997, p. 879). The 2014 enlargement, when Armenia and Kyrgyz Republic joined the EAEU, shown that the EAEU is open, but since the first enlargement took place the question "who is the next" became popular.

The accession of Armenia and Kyrgyz Republic is explained mainly by their economic motives (and security motive for Armenia) and the prospects for the formation of the EAEU common labor market, where migrants from both countries will not be left out. Due to high dependence on remittances from Russia, Tajikistan seems to be the next candidate for accession to the EAEU. Stricter migration rules in Russia have led to significant changes in the pattern of migration from Central Asia; during the 12-month period ending in January 2015 new rules for migrants outside the EAEU countries reduced migration inflows by 70 %, mainly from Uzbekistan and Tajikistan (World Bank 2015b). Thus, the threat of migrant restrictions will push Tajikistan and create pro-integration political activity. Uzbekistan will have a dilemma: being outside the common labor market and facing higher tariffs from the EAEU and bearing high costs from new NTBs, or becoming a member but giving up its self-isolation national strategy. The accession of Uzbekistan could also be costly, if it will keep its "access then withdraw" strategy as in its membership in Eurasian Economic Cooperation or the Collective Security Treaty Organization (CSTO).¹¹ The enlargement process may stop with high resistance to membership of resource-rich Azerbaijan, which has no willingness to join EU or EAEU, and Turkmenistan which keeps the strategy of isolationism.

Market integration requires policy integration, hence the greater the extent of market integration the greater the need for policy integration is likely to be (Sapir 2011, p. 1216). In March 2015 the Russian president Vladimir Putin proposed the idea of common currency, raising the questions of whether monetary union can be realized without political union and whether the EAEU members jealously guarding their sovereignty are ready for this transformation? In the current period, when

¹¹ Uzbekistan became a CSTO member in 2006 and suspended its membership in 2012. Uzbekistan joined EurAsEC in 2006, and suspended its membership in 2008 (Laruelle and Peyrouse 2012).

Russia suffers from external pressure and the region suffers from Russian slowdown, the idea of monetary union and common currency, despite its benefits for the common market and the regional trade, could challenge the existence of EAEU. Eurasian Monetary Union can be created only with the strong support of member countries' population. This can be the case only when EAEU will improve people's well-being and significantly contribute to regional development.

6 Conclusions

The creation of the EAEU is explained by both economic and political motives. The main reasons for the formation of the union include strong economic interdependence due to common history, economic ambitions such as Kazakhstan's National Strategy, underdevelopment and high dependence on migrant remittances, and a perceived threat of economic dominance by China.

The paper showed that despite the concern of becoming stumbling block, the EAEU is an outward-looking integration project, as the majority of participants are WTO members, and the EAEU is sufficiently open not to be a trade-diverting threat to multilateral trading system. Belarus needs further trade liberalization in accordance with WTO norms and if it were to prioritize WTO obligations, as Kazakhstan did in 2015, this could help all the EAEU members to freely trade with the rest of the world. The key to future success is to minimize restrictions on external trade and to remain open for enlargements, leading to widening and deepening.

The Ukrainian crisis had significant implications for Eurasian regionalism and became a reason for concern for the neighbours of Russia. The sanctions imposed on Russia, and Russian counter-sanctions, had negative impact on both Russia and the CIS region. Intraregional trade and investment flows declined, as did the migrant remittances from Russia to CIS countries. Sanctions and countersanctions could lead to significant reduction in real GDP, and as a result to regional instability.

However, this crisis opened new negotiations with the EU, and EU–EAEU engagement could provide a new forum to continue economic dialogue with Russia even under difficult circumstances. Cooperation with the EU is in the interest of all EAEU members, as the EU is their biggest trade and investment partner and source of high technologies. Thus, this dialogue creates an opportunity for further interregional integration which could lead to region-to-region PCA and the creation of a common economic space from Lisbon to Vladivostok. This opportunity should be used for normalization of the relations between Russia and western countries. Russia and other EAEU members should strengthen their efforts for peaceful resolution of the crisis in Ukraine and realization of the negotiations achieved in Minsk.

The current EAEU asymmetry, in which sanctions are imposed on or by one member but not others, is a source of instability, because producers in the imposing or targeted countries can by-pass sanctions by deflecting trade through the non-participating customs union partners. As Belarus and Kazakhstan refused to join Russia's countersanctions, Russia resorted to unilateral actions disregarding legal issues with respect to its customs union partners which are serious violation of the spirit of the customs union. Russia's unilateral actions caused dissatisfaction of its

partners and, in particular, led to conflict with Belarus. Thus, if Russia wants to retain the union it should avoid monopolization of the external agenda of the EAEU.

In sum, in establishing the EAEU in the context of Russia and Kazakhstan acceding to the WTO, the members have shown commitment to open regionalism. The accession of Armenia and the Kyrgyz Republic in 2015 consolidated the focus on WTO-compatibility. This was challenged by the sanctions related to the Ukraine Crisis, but the response of Belarus and Kazakhstan reduced the systemic threat. In the initial stages of institutional development the EAEU should concentrate on internal economic issues such as abolition of non-tariff barriers, harmonization of macroeconomic and financial policies and improvement of technological capabilities. Deeper economic integration, such as creation of Eurasian Monetary Union, must be supported by all member countries, and can be the case only when the EAEU significantly contributes to the whole region's development. In this was, creation of the open economic system with open society can remain the goal of all EAEU members.

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