

St. Petersburg University
Graduate School of Management

Master in Management Program

**SOCIAL AND ECONOMIC CONSEQUENCES OF
TAJKISTAN ENTERING CUSTOMS UNION**

Master's Thesis by the 2nd year student
Concentration — International Business
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St. Petersburg
2017

ЗАЯВЛЕНИЕ О САМОСТОЯТЕЛЬНОМ ХАРАКТЕРЕ ВЫПОЛНЕНИЯ
ВЫПУСКНОЙ КВАЛИФИКАЦИОННОЙ РАБОТЫ

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Аннотация

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Название магистерской диссертации	Социально-экономические последствия в Таджикистане от вступления в Таможенный Союз
Факультет	Высшая Школа Менеджмента
Направление подготовки	Международная Бизнес
Год	2017
Научный руководитель	Василий Константинович Дерманов
Описание цели, задач и основных результатов	<p>Цель исследования - найти социальные и экономические последствия, если Таджикистан войдет в Евразийский таможенный союз.</p> <p>Основными задачами являются:</p> <ul style="list-style-type: none">• Определить влияние Таможенного союза на торговый баланс;• Проанализировать разницу в торговле в рамках Таможенного союза и третьих стран;• Показать изменения в направлениях импорта и экспорта;• Определить влияние Таможенного союза на прямые иностранные инвестиции;• Определить миграционный отток после вступления в Таможенный союз. <p>Основные результаты:</p> <ul style="list-style-type: none">• Было выявлено влияние Таможенного союза на торговый баланс;• Была исследована разница в торговле между Таможенным союзом и третьими странами;• Были описаны изменения импортных и экспортных направлений;• Было обнаружено влияние Таможенного союза на прямые иностранные инвестиции;• Выявлена тенденция воздействия Таможенного союза на миграцию.
Ключевые слова	Таможенный союз, Евразийский экономический союз, Таджикистан, экономическая интеграция

Abstract

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Master Thesis Title	Social and economic consequences of Tajikistan entering Customs Union
Faculty	Graduate School of Management
Main field of study	International Business
Year	2017
Academic Advisor's Name	Vasiliy K. Dermanov
Description of the goal, tasks and main results	<p>The goal of the research is to find social and economic consequences if Tajikistan enters Eurasian Customs Union.</p> <p>The main tasks include the following:</p> <ul style="list-style-type: none"> • To identify the effect of Customs Union on trade balance • To investigate the difference on trade within Customs Union and third countries • To display the changes on import and export destinations; • To find the influence of Customs Union on Foreign Direct Investments • To identify the migration outflow after becoming member of Customs Union <p>Main results:</p> <ul style="list-style-type: none"> • The effect of Customs Union on trade balance was identified • The difference on trade within Customs Union and third countries was investigated • The changes of import and export destinations were described • The influence of Customs Union on Foreign Direct Investments was identified • The effect Customs Union on migration was founded
Keywords	Customs Union, Eurasian Economic Union, Tajikistan, economic integration

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INTRODUCTION

Collapsing Soviet Union caused disintegration processes. In the late 2000s tangible efforts were made to unite former members in the form of the new integrated structure of the Commonwealth Independent States (CIS) and the Eurasian Economic Community (EEC). Within the framework of the Eurasian Economic Community, the regime of free trade in goods operates. During 8 years of this community the trade between member countries increased several times but Financial Crisis of 2008 had negative effect on trade. The head of three members of EEC, Belarus, Kazakhstan, Russia, decided to form Customs Union (further CU). The first treaties agreed under the Single Economic Space (further SES) came into force in 2012. The SES is designed to ensure that the legislation regulating all of the various aspects of cooperation between its countries is synchronized. It also enables the freedom of movement of goods, services, labor and capital.

Since January 1, 2015, the Eurasian Economic Union (further EEU) has officially started operating. This was the stage of maximum integration without loss of sovereignty by the member countries of the union. In the beginning of 2015 Armenia became a member of the EEU and on August of that year Kirgizstan also joined the union. According to Evgeny Vinokurov the director of the Centre for Integration Studies, the only real next candidate for joining the Eurasian Economic Union is Tajikistan. The President of Republic of Tajikistan repeatedly said that Tajikistan is interested and want to become the member of EEU. In addition, it was mentioned by him that now Tajikistan just learning all possible economic and social consequences of entering to EEU and we do not want to hasten.

In this work there will be analysis of social and economic consequences if Tajikistan enter EEU and CU. The relevance of this work is obvious, first of all because it is a new topic and widely discussed today. Second, there are few studies about Eurasian Economic Union and Customs Union at all.

The objectives and goals of this work is to analyzing the possible effects in economy if Tajikistan become a member of CU. How Tajikistan can get benefit from it and what possible challenges it will face with? What kind of social benefits or problems it will bring? The main goal of this work is to use the Case study as a Research Method to analyze the several countries. Kyrgyzstan, Kazakhstan and Belarus will be analyzed because they are already member of CU and the goal of this analysis is to find social and economic effects after they joined the union.

1. THEORETICAL BACKGROUND

The purpose of this chapter is to define and analyze a theoretical paradigm for research. In the course of this analysis, research gaps need to be identified so that they can be accomplished through empirical research. The most important part of this chapter is a comprehensive theoretical review, which consists of various research areas related to economic integration and the Customs Union. After an objective comparison and analysis, research gaps will be identified. In this chapter, I will review all theories and review literature on major related topics. The objective of this analysis is to produce well-argued conclusions with regard to the potential social and economic impact of Tajikistan's accession to CU and the SES.

1.1. Trade Regulation

International trade today involves navigating free trade agreements (FTA), Customs Unions, Bilateral Investment Treaties, and a host of other international agreements. Tariffs are only one of the factors restricting trade. Non-tariff barriers are significant and may actually be overtaking tariffs as the primary way to regulate international trade (Baldwin, 2011).

Countries regulate the flow of goods into and out of their countries because of structural, technological, and economic differences between countries. Trade agreements attempt to remove inefficient trade barriers in ways that benefit both countries. Regional trading blocks are becoming more and more important (Baldwin, 2011). The Customs Union in Eurasia is just one example of a regional trade agreement.

Tariffs have been one of the more common ways to regulate trade. A tariff raises revenue for the government and raises the price of a good within the country by taxing it at the border. Higher internal prices of a good usually mean that foreign companies will sell less and their profits will be smaller. This is of course bad for the foreign companies, but shields domestic producers from competition.

Countries often use tariffs to protect domestic enterprises that can not compete in the international market. If the domestic industry can not afford to sell its products at a price on the world market, it can put a tariff on foreign goods in order to raise prices to a level that the domestic market can afford. A country can do this if a significant part of the labor force is employed in the industry. The potential negative effect is that the domestic industry will not introduce innovations in accordance with international standards. In developing countries, such as Tajikistan, which gradually reduce tariffs for several years, the industry can gradually adapt. Sometimes tariffs are used as political tools for responding to tariffs of other countries or harmful trading methods.

Non-tariff barriers to trade can also be used as political tools (especially in Russia), but may simply be the result of bureaucracy. Governments want to know what is coming in and out

of their country, so they need documentation. This documentation slows down the trade. Sanitary and safety rules are usually designed to protect consumers, but they can be major barriers to trade. Such rules are the most problematic if they are not agreed between countries. Manufacturers are not easily convinced that their products meet the standards of each country.

Trade agreements and trade organizations provide rules on how a country can set its tariffs and often try to eliminate non-tariff barriers. Members of the World Trading Organization (WTO) should use the Most Favored Nation (MFN) tariffs. The MFN rate is the tariff rate that the country charges from all other countries. A country can not charge from another country a tariff that exceeds the MFN rate, although it can increase its MFN. The caveat is that the WTO allows free trade agreements and customs unions. Members of the WTO who form free trade agreements may charge a lower tariff from their partner, but they can not levy more MFN tariffs from any country.

1.2. Customs Union Theory

Traditionally, the customs union consists of two or more countries that have eliminated tariff barriers among themselves in order to improve the welfare of trade unions and maintain a common external tariff (CET) for the rest of the world. (Hazelwood: 1987) Before the theory of the "Second Best" postulated by Mead (1955) and extended by Lipsey and Lancaster (1957), it was considered that the creation of the CU is a step towards the liberalization of free trade through the use of cheaper imports for members and trade coordination Policies on rules of origin.

A customs union is one way for countries within a specific region to coordinate their international economic activity. A customs union usually consists of a common external tariff between all the member countries and tariff free trade among member states. So a firm importing a good into a customs union would have to pay the same tariff no matter which member country it imported to, but firms within the union could export to other union members tariff free. The common external tariff is important because the customs union is internally also a free trade zone. Without the common external tariff, a company could import goods wherever the tariffs were lowest and then ship the goods to other countries through the free trade zone tariff free. A customs union may also reduce non-tariff barriers by synchronizing regulations and removing customs processes that impact international commerce, but each international agreement is unique.

A customs union is more complex than a free trade agreement. Free trade agreements typically regulate the tariffs that countries charge those with whom they make the agreement. They do not regulate tariffs charged to countries not in the trade agreement. Free trade agreements may also regulate non-tariff barriers such as sanitary regulations and border control

mechanism. Bilateral investment treaties frequently accompany free trade agreements as a way to ease regulation to promote investment and collaborative commerce between two countries. Customs unions usually include all aspects of free trade agreements and more.

So why would a country seek to form a customs union rather than just a free trade agreement? Often customs unions are motivated by regional efforts to integrate or at least coordinate economies. Countries that are close together geographically tend to trade more with each other. This is called the gravity principle (Krugman, 2009, 13). On average the closer two countries are the more they will trade with each other all else equal. For example, Tajikistan trades more with China and Kazakhstan, two countries it borders, than with the European Union (EU). It trades more with the EU than with the United States. So countries that are close together could mutually benefit from free trade with each other.

The higher levels of trade that come with proximity only increase the level of economic integration of neighboring countries. Such countries may have similar industries, or integrated industries where different stages of production are performed in different countries. Collectively they may want to protect these industries from foreign competition. A common external tariff is one way these countries could jointly protect an industry from foreign competition. Protectionism often has a negative connotation, but governments understandably will try to support the major industries in their countries. Countries that are neighbors may also want to coordinate their economies to increase overall output. A customs union could create conditions that would lead to more coordination across countries in the union. Geographically close countries may have similar economic goals and may be in similar stages of economic development.

1.3. Purpose of Customs Union

Trade, in theory, makes all trading partners better off. A country's comparative advantage or its ability to produce a good at a lower opportunity cost than other countries, allows countries to increase their wealth and resources by exchanging goods with other countries. However, technology can change a country's comparative advantage. Structural change often occurs much slower than technological change. As a result, trade will cause some people to suffer when comparative advantages change, but trade should still increase total aggregate well-being.

In this section I first briefly describe the theory and purpose of tariffs and other types of trade regulations. I then explain the basic theory of a customs union and how it differs from a free trade agreement. Next I provide examples of existing customs unions and finally I give a description of the Eurasian Customs Union.

1.4. Advantages and Disadvantages of Customs Union

A customs union pulls down the economic barrier between the union countries. This will result in a better division of labor and consequently in an increase in production and prosperity. The increase in production and prosperity will probably in many cases be very substantial. It will not only benefit the union countries, but also, though of course to a smaller degree, the rest of the world. An increase in prosperity in a certain area will spread over other areas (except when there are no economic relations between this area and the other areas).

From the advantage of the increase in production and prosperity has to be subtracted, however, the disadvantage which results from the adjustments which a customs union will cause. A better division of labor means a change in the division of labor. The customs union will bring about shifts in industry and trade of the union countries: tomato-growers in country A will find the competition of tomato-growers in country B, against which they were hitherto protected, too much for them and will be driven out of business; cycle-manufacturers in B will suffer the same fate as a result of the competition of their rivals in A, etc. These shifts will not only cause pain and hardship to the people who are their victims, but will probably also cause some unemployment; the cycle-manufacturers and their employees in country A, whose business has been ruined, may not immediately find other employment. (Weststrate, 1948)

This disadvantage, of course, is proportionate to the size of the shifts which follow in the wake of the customs union. The greater these shifts, the greater the disadvantage. However, the greater these shifts, the greater the advantage. It may safely be assumed, therefore, that after the subtraction of the disadvantage a balance of advantage will remain, at least if the life of the customs union is long enough.

Another advantage often pointed out by the advocates of a customs union is the fact that the union increases the size of the market which is open, without any hindrance, to the industries of the union countries; and this increase may make possible the foundation of new industries which still did not find a sufficient market in either of the countries alone. One can imagine, for example, that automobile manufacture is an economic impossibility in small country A or in small country B; the market for cars is too small in each of them. But when A and B unite their markets, the combined market may be large enough to support an auto- mobile factory.

This advantage is not of the same kind as the one mentioned first. It is not an advantage from the world point of view. When countries A and B found an automobile industry, there is no reason to suppose that production and prosperity in the world as a whole will increase, for it does not follow that they will be able to manufacture cars more cheaply than countries C and D, hitherto the producers of cars. There is even no reason to expect that prosperity in A and B will

increase. The advantage lies solely in the fact that they are, taken together, economically less dependent on other countries.

Another argument of equally doubtful value runs as follows: the union gives the member countries a stronger bargaining position in trade negotiations with other countries. That this is the case, is of course undeniable: the union bargains with other countries as a whole, and as a whole it has a greater bargaining power than its components- have separately. This may be an advantage for the union countries, but it is at the same time a disadvantage for the other countries, and consequently cannot be regarded as an advantage from a general or world point of view.

1.5. Existing Customs Unions: EU, Mercosur, EEU

1.5.1. European Union

The most prominent and successful example of a customs union is the European Union. European Union is much more than a customs union but it has taken a long time to develop into what it is today. Six European countries first made an agreement to form a common economic market in 1957 with the goal of complete market unification. The purpose of the European integration project was always more than just economic integration. After two world wars integrating economically and politically would, they hoped, maintain peace and stability. Although the economic agreement was signed in 1957, the six countries did not implement an actual customs union until 1968 when they established a common external tariff and removed all internal customs duties (European Union, 2014). Over the next 40 years the European Union increased integration by harmonizing economic regulations, allow free movement of people across borders, and implementing a common currency. The union also took on significant non-economic policy issues.

Europe's long integration process has benefitted the continent tremendously. In Europe, the union is useful because of the relatively large number of small states in a small geographic area that all rely on each other economically. Now European firms have free access to markets all across Europe rather than in just their own small country. A single currency simplifies transactions and a common external tariff for Europe simplifies trade with other nations.

1.5.2. Mercosur

Mercosur is another major example of a customs union. In 1991 several South American countries began working to create a unified economic market (the Andean Community is another customs union in South America) by establishing a customs union. This union includes Brazil, Argentina, Venezuela, Uruguay, and Paraguay, with plans to expand to other South American countries. Although these countries vary widely in both size and economic structure (Brazil makes up over 75 percent of Mercosur's total GDP according to Klonsky, (2012)), they have

been able to implement a common tariff on over 80 percent of the tariff lines. Because of the major differences in these countries, completely coordinating their economies has been challenging. Although Mercosur's purpose was initially economic integration, recently there have been proposals on other types of policy coordination. Political disputes have complicated economic integration efforts. Despite the challenges Mercosur has faced, the EBRD (2012, 66) has recognized significant benefits that have accrued to Mercosur's members.

Table 1. List of Customs Unions and Trade Agreements.

Source: Barbee (2012) *The Path to Customs Union*

Agreements	Date
Southern African Customs Union (SACU)	1910
Switzerland-Liechtenstein	1924
European Union (EU)	1958
Central American Common Market (CACM)	1961
Caribbean Community (CARICOM)	1973
Andean Community (CAN)	1988
EU-Andorra	1991
Southern Cone Common Market (Mercosur)	1991
Israel-Palestinian Authority	1994
EU-Turkey	1996
Eurasian Economic Community (EAEC)	1997
Economic and Monetary Community of Central Africa (CEMAC)	1999
West African Economic and Monetary Union (WAEMU)	2000
East African Community (EAC)	2000
EU-San Marino	2002
Gulf Cooperation Council (GCC)	2003
Customs Union of Belarus, Kazakhstan and Russia	2010
Arab Customs Union (ACU)	2010
Southern African Development Community (SADC)	2010
Economic Community of Central African States (ECCAS)	2011
Economic Community of West African States (ECOWAS)	2015

1.5.3. Eurasian Customs Union

From its name, one can assume that the CU is foremost an economic project aimed at facilitating trade among its partners and harmonizing trade policy towards this parties. The origins of the CU project can be traced back to January 6, 1995, when Russia and Belarus signed the bilateral Customs Union Agreement (Shadikhodjaev 2009, p. 559). In the same month, Kazakhstan joined, and a year later by Kyrgyzstan (Simon 2010, p. 1 1). In February 1999,

shortly after the August 1998 Russian financial crisis, these countries, as well as Tajikistan, signed a new Treaty on Customs Union and Single Economic Space (Shadikhodjaev 2009, p. 559). Since 2000, the project continued in the framework of the The Eurasian Economic Community (EurasEC), with Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan as full members, and Armenia, Moldova, and Ukraine acted as observers whereas Uzbekistan joined in 2006, but its membership was suspended in 2008 (About 201 1).⁵ Despite having all the attributes of an international organization (Shadikhodjaev 2009, p. 560), it was argued that in practice the EurAsEC amounted to no more than a free trade area with substantial (around 60%) but not complete tariff unification and some anti-dumping procedures (Glinkina 2008, p. 6;6 Simon 2010, p. 1 1).

After a decade and a half of talks on economic integration Kazakhstan, Russia, and Belarus agreed to a common external tariff in 2009 and began implementing this tariff January 1st, 2010. The common external tariff was just the first step of integration efforts. Beginning in July 2011 all customs control stations between Russia, Belarus, and Kazakhstan were abolished moving the union closer to its goal of a single economic space. In February 2012 the Eurasian Economic Commission became the administrator of the Customs Union, meaning member governments no longer controlled customs stations at their own borders. The Eurasian Economic Commission began collecting and distributing customs duties. Headquartered in Moscow, the Eurasian Economic Commission is also working to establish the institutions necessary for the customs union member states to become a single economic space. The customs union is on scheduled to become a single economic space called the Eurasian Union in 2015 as long as the countries sign this agreement in June 2014. The single economic space will allow for the free movement of goods people, and capital among the three countries. The commission has discussed a common currency, but the member countries have not yet agreed to this. After more than a decade of discussions Kazakhstan, Russia, and Belarus and are making significant progress toward integration of their economies (with several other former Soviet Republics preparing to join).

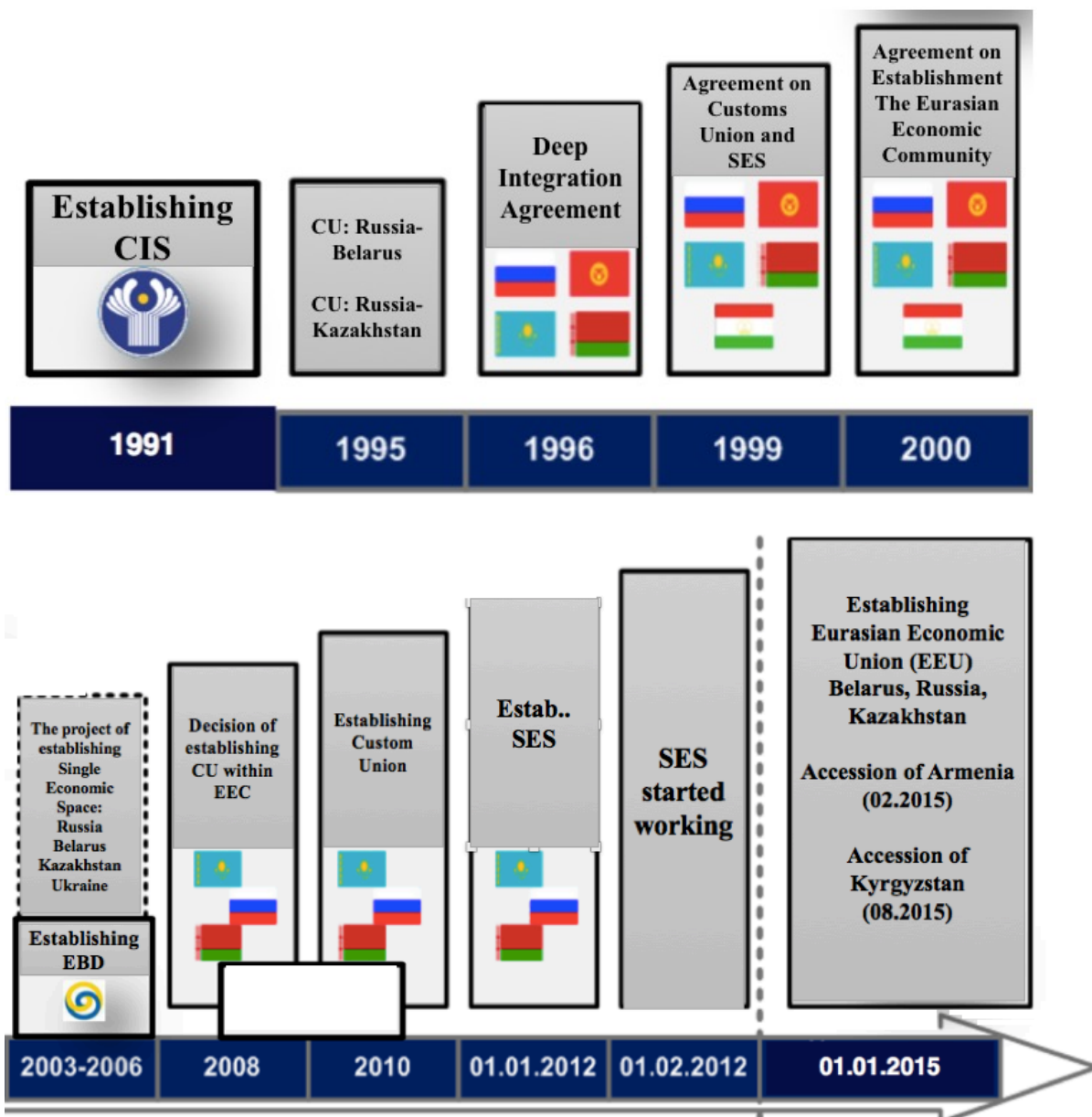


Figure 1. The History of Eurasia Economic Integration
Source: Eurasian Development Bank

1.6. Evaluating Effects of Accession to Customs Union: EU

The European Community - the largest and most highly developed customs union in the world history. Customs Union, according to the Treaty of Rome, became the basis for the functioning of the Community, the starting point for further economic integration of the Member States. EU experience gained in the establishment and development of the customs union, it acquires great value for the countries-participants of integration processes in the post-Soviet space.

Scientists, philosophers wondered idea of a single united Europe dating back to the XIV century (P. Dubois, later Kant). However, the integration processes in the context of the European Customs Union began in 1951, after the creation of the European Coal and Steel Community (ECSC). The impetus for the formation of this plan served as the Robert Schumann and Jean Monnet, who, in particular, are included in the unification of Germany and France in the field of steel and coal industries. Its creation involves strengthening the unity of Europe after the war by the recovery in Germany, but only in the framework of cooperation of the European states. This circumstance was to make it impossible for another war in the western part of the European continent.

Several times people tried to assess economic performance of European Economic Community (EEC) since it was created. Customs Union (CU) has many costs and benefits to create. Before embarking on study of the actual costs and benefits lets outline the theoretically what we should expect to see. The Table 2 shows the effects of formation of CU. As we know the hierarchy of regional economic arrangements the order is following: FTA, CU, Common Market, Economic Union(Ballasa,1961). But what EEC wanted was to create CU and common market at the same time. Common market may arise additional effects mainly by removing all barriers including labor and capital.

Table 2. The impact of Custom Union
Retrieved from Barbee (2012) The Path to Customs Union

Action	Impact
Removal of tariffs between member countries	<ul style="list-style-type: none"> • Free movement of goods • Increased competition, specialization • Economies of scale, lower unit costs • Increased consumer choice, lower prices • Attract foreign direct investment • Expanding production, technical efficiency • Low cost suppliers can increase exports to member countries, but in the short term, their consumers will face higher prices since supply is imperfectly elastic. Will either change as a result of industry expansion along its domestic supply curve, or the creation of a common price on products • Geographically limiting
Establishment of a common external tariff to the outside world	<ul style="list-style-type: none"> • Elimination of rules of origin between member countries • Reduction of transportation and transaction costs • Bargaining power in international trade negotiations, improved terms of trade • Trade creation • The higher the external tariff rates, the more adverse its impact on third countries, possibly leading to trade diversion if the lowest-cost producer is not within the customs union for a product adversely affected by the increased tariff • Member countries give up independence in setting tariff rates • Possibility for a common commercial policy

Liberal economist believes that CU increases free trade and as the result the total welfare increase in the world but other people have to analyze this assumption by themselves. The pioneer in evaluating CU is Jacob Viner. He also invented the terms trade creation and trade diversion (Viner, 1950). Trade creation takes place when “economic integration leads to a shift in product origin from a domestic producer whose resource costs are higher to a member producer whose resource costs are lower,” thus allocating resources in such a way as to increase overall welfare as costs are reduced; trade diversion does just the opposite by shifting “product origin from a nonmember producer whose resource costs are lower to a member-country producer whose resource costs are higher,” moving away from the free-trade allocation of resources and thus reducing welfare (Appleyard, p 388).

Both can be experienced through economic integration, and thus integration can be considered a partial movement to free trade; to fully evaluate the net benefit to countries requires an empirical examination of the issue (Meade, 1962). This is exactly what Viner argued, in that economic integration itself does not produce automatic increases in welfare, and as a result, trade creation and trade diversion were instrumental in evaluating the effects of integration.

Viner’s theory was widened by Meade by additional factors to analyze the effects of CU. Meade suggested that the initial height of tariffs and the size of cuts, competitiveness or complementarity of the economies taking part, elasticity of demand and supply, change in the amount of consumer surplus, effect on the terms of trade, and the relative incomes from whom trade was diverted, be taken into account (Pinder, 1968). The problem with Meade's method was that he used the measures of static effects of creating trade and diversion of trade, that is, those effects that arise directly when creating an integration project.

This is problematic, since often dynamic effects, such as the impact on competition, investment and the balance of payments, have a significant impact. Thus in addition to studying the static effects, it is necessary to study the possible effects, if integration has not occurred.

In order to obtain realistic estimates of the creation and diversion of trade Bela Balassa developed these theories. The Balassa methodology used the elasticity of demand for imports after the post-income period (YEM), which is the ratio of the average percentage change in imports to gross national product (GNP), expressed in constant prices. Balassa suggested that, assuming that the elasticity of demand for imports would remain unchanged without integration, that increasing the elasticity of import demand within the region in the area of imports would thus indicate the creation of gross trade. Thus, diversion of trade will be observed due to a decrease in the elasticity of demand for imports outside the region in terms of income, and the actual creation of trade will be "indicated by the growth of YEM for imports from all sources, partners and the outside world." (Appleyard, p. 390). If the latter occurs, this indicates that the

EEC has become more susceptible to imports as a whole through integration and that the departure from domestic production has been relative.

To measure these effects, Balassa compared YEM before the EEC came into force from 1953-1959 to YEM from 1959-1970. He discovered that in the early stages of economic integration, especially in the beginning of introduction of the customs union, the creation of trade was not only significant, but also many times higher than the volume of trade flows in absolute terms. This trade creation was the outcome of the intra-industry specialization in production and economies of scale. In fact, 10% of the growth rates of the common market in 1970 could be explained by the economies of scale benefits resulting from the rationalization of production (Balassa, 1975). The YEM for intra-zone imports increased from 2.4% in 1953-1959 years to 2.7% in 1959-1970 years. In general, an increase in gross national product by 1% led to an increase in in-country imports by 2.7% in the period 1959-1970, which indicates that integration is working. The greatest increase in YEM occurred in fuel, chemicals, machinery and transportation equipment. A general leakage in trade did not take place, as YEM remained unchanged at 1.6%, but leakage occurred for specific products, such as non-tropical food, beverages, tobacco, chemicals and other manufactured goods (Appleyard, p 391). Actually, about 10% of the creation of trade was noted, mainly due to the growth of YEM for general imports. Balassa's analysis is important because it takes into account the dynamic effects of economic integration, and at the same time shows that integration within the EEC in 1959 -1970 undoubtedly led not only to the creation of trade, but also to the general welfare.

It is important to mention that not everybody agree Balassa's analysis, and over time, other ways appeared to assess the impact on trade from the customs union. However, there is no more effective way to measure, and the Balassa approach remains useful today, although some dispute its findings. In the end, economists generally agree that the impact on trade from the formation of a customs union is positive, although the overall effects may be small (Harrop, 2000). In addition, even if trade is distracted, consumer prices are usually reduced because of tariffs being removed, that lead to the conclusion that general welfare from the creation of a customs union trend is positive (Harrop, 2000). Since the external tariff for the outside world is shrinking, one could expect further improvement in welfare, but the EEC was experiencing special problems with the member states that introduced other fiscal measures for their citizens in connection with the discharge of the duty, which led to a reduction in CET is virtually invalid. This is important, because it distinguishes the theory of the customs union from real practice. There are a number of gaps that Member States can use to protect their industries, although some of these measures are legal in accordance with the provisions of the Treaty, many others do not

have a permit and therefore have a negative impact. That is why, at the end of the transition period, the Commission noted that the customs union had not been fully completed.

Wilfried Prewo also conducted an analysis of the impact of the customs union on trade flows, but while many researchers examined the extent of the creation of trade and diversion of trade, analyzing the influence of the union on imports, Prewo intended to examine the impact of the union on the activities of EEC Export. His study examined the export performance of the EEC countries between 1959-1965 years and 1959-1970 years. He divided the national economy by sector, and then used the general equilibrium model to link all sectors together, striking out the impact of growth on trade flows "to the extent that they would have been preserved in the absence of an EEC establishment." (Prewo, 1974). The economies of each country were broken down into seventeen sectors eleven of which were treated as the production of goods sold and were the focus of analysis. Prewo noted that between 1959 and 1970, the share of exports within the EEC increased by 50%, and the total share of EEC exports to third countries decreased by 24%. Nevertheless, despite the diversion of exports from countries outside the EEC countries, this decline occurred in specific sectors, while others, such as producers, benefited from the customs union, outweighed the decline in other areas. Agricultural and food products experienced double exports due to increased exports within the EEC, and exports to third countries increased, albeit between half and one-third of domestic exports (Prewo, 1974).

Table 3 shows the negative and positive percent changes in exports by country, as well as data indicating that the consequences were not uniform across the board. It is interesting to note that during the period 1959-1965, relatively early in the integration process, half of the member states faced a reduction in total exports, but for another five years each state experienced an increase. The largest increase in Italy's exports was observed both in the EEC countries and in non-EEC countries, followed by France, Germany, the Netherlands and Belgium-Luxembourg. This is fascinating, as Italy and France are high tariff states, and it is expected that countries with a low tariff will experience the highest export growth, since the customs union reduced tariffs to previously high tariff countries. However, the growth of competition, as a direct result of the customs union, prompts previously high-tariff states to switch from foreign trade policy to an export-oriented strategy, causing an increase in exports. Since lower tariff rates lead to an increase in imports, countries adjust their trading strategies to remain competitive and balance the balance of payments. In this particular case, it should also be noted that France also benefited from the devaluation of the franc at the end of 1958.

Table 3. Percentage Change in Exports, by Country (1959-1965 and 1965-1970)

Source: Wilfried Prewo, "Integration and Export Performance in the European Economic Community"

Country	Year	Intra-EEC Exports	Extra-EEC Exports	Total Exports
Belgium-Luxembourg	1965	-8.7%	-8.9%	-8.8%
	1970	12.1%	-1.3%	7.6%
France	1965	31%	-16%	-1.7%
	1970	92%	-2%	28%
Germany	1965	24%	4%	10%
	1970	68%	31%	43%
Netherlands	1965	24%	-26%	-4%
	1970	62%	-19%	17%
Italy	1965	107%	13%	39%
	1970	161%	34%	70%

The negative figures observed by Belgium and Luxembourg in 1959-1965 may be explained by the fact that intra-Benelux preferences were abolished, which led to a reduction in traditional export operations inside the Benelux. It took some time before Belgium and Luxembourg were able to compare their export cuts that would have gone to the Netherlands with exports to other EEC partners; By 1970, all these negative indicators had become positive. This is also a possible reason that Dutch exports to third countries suffered the greatest decline, with the exception of fuel and chemicals, in all other sectors, exports fell. It should be borne in mind that the Benelux countries already had the lowest tariff rates in the EEC, and in some cases were forced to raise rates at certain rates in accordance with the CET. As a result, one would expect that the consequences of the customs union will have a minimal impact on these countries, since they are already very open to trade and can not continue liberalization without creating imbalances within the Community. Thus, Benelux suffered the first casualties, while the other three caught up - as the level of trade liberalization leveled, there was a change in the volume of trade.

In general, trade within the EEC has increased significantly, but in smaller Benelux countries, it appears that there is less growth in their exports at an early stage. This is important for understanding the impact of market size on economic integration. As states compete for economies of scale, the larger the market size, the greater the means for competition. Although the Netherlands and Benelux showed positive signs of export growth from 1965-1970, the early years were slow. As a result, Germany, Italy and France benefited most from the customs union, especially in the early years. If you look at the figures in absolute terms, Germany comes out on top not only as the main exporter, but also as the leader in exports within the EEC mainly.

Table 4. *Extra-EEC Trade with the World, Exports & Imports (in billions)*

Source: Eurostat, *External and intra-EU trade Statistical Yearbook, Data 1958-2009*

Year	Total Exports	Total Imports
1958	64.2	68.6
1960	78.5	82.1
1970	200.8	210.9

As shown in the above analyzes, economic integration has the greatest positive impact under the following conditions: a higher level of pre-trial detention tariffs combined with a low overall external tariff. Elastic offer and demand, increase in the number of union members, the ease of transition from a more expensive internal source to a cheaper member source, a higher difference between unit costs between two sources and greater opportunities for economies of scale and attracting FDI (Prewo, 1974). Of course, countries should also be geographically contiguous in order to maximize the benefits of lower transport costs.

Jovanovic and Damnjanovic in the paper analyzed the EU eastern enlargement and economic effects on new members. In addition, they describe migration flows from new members more developed ones. According to their paper after the EU entry in 2007, Romanians flocked to Spain among other countries. The old 15 EU countries may not impose restrictions on labour mobility, but they were able to do so for the new members from the east for a period of seven years after their EU entry. For Bulgaria and Romania, the expiry date of this limitation was 2014. Spain decided to lift this restriction in 2009 and more than 800,000 Romanians migrated to Spain where the language similarity played a certain role. They outnumber Moroccans, Ecuadorians and almost Britons living in Spain. The booming construction business in Spain brought strong demand for their labor services. However, the recession had a negative impact on the construction of new dwellings and shopping centres and thus about 30 per cent of Romanians living in Spain were unemployed in 2011. Under EU rules, the unemployed are eligible to receive the same unemployment benefits as local people. The economic situation was so harsh that Spain re-imposed barriers to the inflow of new migrants from Romania in 2011. The European Commission approved such a temporary measure until the end of 2012 (Jovanovic & Damnjanovic, 2014).

Over 3 million Romanians and over 1.5 million Poles live abroad. Smaller countries such as Lithuania and Bulgaria are the most depopulated in the EU. Bulgaria has 7.3 million inhabitants and the country has lost 1.5 million people since 1985. This is a high depopulation record not just for the EU, but also by global standards. Even though the eastern EU countries

may be suffering from depopulation, these people still live in the EU. Such developments are similar to what happened during the 1980s when Spain and Portugal joined the EU

Jovanovic and Damnjanovic also claimed that integration and EU entry stimulated inflow of FDI in the east of the EU. The biggest beneficiary of FDI inflows was Poland where the size of the domestic market also played a role in the attraction of FDI. Even though these countries were net beneficiaries of FDI, they were also a source of FDI. One may note an exodus of FDI from Hungary, especially after 2010. Some investors were leaving for China. (Jovanovic & Damnjanovic, 2014).

Miloslav Bahna in his paper tried to predict the migration from the new member states from Central and Eastern Europe after their accession into the EU. One of the important findings highlighted in that article was the strong association between per capita size of the national economies (as measured by GDP) and level of migration from the accession states in Central and Eastern Europe. The high correlation between attitudes toward migration and actual migration from accession states to Western Europe would seem to have an important instrumental component that was captured by neoclassical economic theories of migration. Although GDP proved to be a good "objective" indicator of migration potential, the "subjective" intention to move to an old Member State appears to be more strongly associated with migration. This finding implies that although migration is strongly motivated by material considerations there are nonetheless additional reasons that are best captured using attitudinal questions asked in mass surveys (Bahna, 2008).

So according to Bahna's findings the countries with the highest GDP per capita are the most attractive destinations for migrants. As neoclassical economic theory states that the existing differences in income caused by differences in the proportion of labor to capital, encourage workers in low-wage countries to migrate to high-wage countries. The free movement of goods, people and capital is characterized by two main channels: the first is represented by the flow of labor migrants from low-income countries to countries with a higher level of income; The second is a flow of capital from the industrially developed countries to countries with a low level of wages (Öberg, 1997). This should lead to equilibrium, because over time, there is a decline in wages in the recipient country, while their level in the sending country will increase.

Roberto A. De Santi in his work analyzed the impact of Customs Union (CU) with European Union (EU) on Turkey's welfare, income and employment. The economic implications and the income distribution effects of the CU between Turkey and the EU have been studied by applying a general equilibrium model to the Turkish economy under alternative hypotheses for the labor market. The results show that, regardless of the assumptions postulated for the labor market, manufacturing production and trade, in particular textiles, wearing apparel, leather and

fur products, grow despite the protection loss and the standard VAT rate has to increase for the trade policy to be revenue neutral (Santi, 2000). The CU is potentially Pareto superior. Urban groups are better off in the wage curve scenario, where wages and unemployment are negatively related; while urban groups are worse off in the scenario with fixed or flexible real wages. Also the impact on income inequality is ambiguous, rising in the wage curve scenario. This latter result is partly driven by the large impact on income inequality between urban and rural groups. However, despite the relatively large fall in tariffs, the impact on overall income inequality is small. Regarding the impact on employment, the model predicts the creation of 68,000 new jobs in the wage curve scenario, and the loss of almost 100,000 jobs in the scenario with fixed real wages (Santi, 2000).

The work by De Santi leads directly to an other important result, which is related to the issue of international trade and income inequality. Despite the large fall in tariffs, the impact on overall inequality is small, suggesting that trade is not the key factor in explaining large changes in the distribution of income. So according to his findings distribution of income will not increase even after the trade increase as the result of fall in tariffs.

Elekes (2004) analyzed the effect of Common Agriculture Policies that was one of the step of European integration. He stated that the Common Agricultural Policy (CAP) is a very complex area of the European integration. As agriculture (especially agricultural trade) plays a very important role in the Hungarian economy, agricultural adaptation and its competitiveness is a crucial question for the whole economy. It is worth then examining how market players are expected to respond to new market challenges. In order to reveal some competitive effects of CAP adaptation, I turned to customs union (CU) theories, focusing on the possible theoretical production and consumption reactions. Finally, the relevance of these presumptions to Hungarian agricultural accession is explored, revealing certain competitive effects. Elekes (2004) found that after Hungary's EU accession, producers enjoy the following benefits of the customs union:

- better exploitation of economies of scale for both farms and industries operating below optimum capacity before the integration occurs - increased production;
- economies external to the farm which may have a downward influence on both general and specific cost structures;
- improved terms of trade with the rest of the world;
- increased competition among farms within the CU - forced increases in efficiency;
- increased capital inflows and increased rate of technological change; -
- structural change;
- reduced uncertainty - increased efficiency.

Gains from economies of scale, increased specialisation and enhanced competitiveness (that is, market expansion) certainly lead to a faster rate of growth and induce an increase in investment creation, further increasing the growth rate. However, it is also possible that the adoption of the Common Agricultural Policy produces investment diversion with investment being diverted from its most rational location in the economy.

Sales and export earnings are expected to increase. Full liberalisation, however, will bring a more intensive competition not only on the common market, but also on the domestic market. Competitive position of the Hungarian producers will be influenced also by the developments of the international agricultural markets and by the exchange-rate fluctuations. It is also important that once tariffs and quantitative obstacles to trade have been reduced to zero, differences in taxes and national regulations become a major factor influencing intra-zone business competition.

1.7. Research Gap

The research gap: lack of research related to Eurasian Customs Union, in particular – social and economic effects of accession to Customs Union. In addition, there was gap on effects of CU on labor market and migration.

Because of shortage of information about Eurasian Customs Union I decided to analyze European Union and found about increase in export and trade creation. But one should understand that the difference between EU members and CU is significant. Therefore, existing research, aimed to identify the possible effects of Eurasian Customs Union to Tajikistan as a potential member.

The **goal of the study** to create an overview of Eurasian CU and to identify the effects of joining CU for Tajikistan.

The objectives of this study are:

- To identify the effect of CU on Trade Balance.
- To investigate the difference on trade within CU and third countries
- To display the changes of import and export destination
- To find the influence of CU to FDI
- To identify the migration outflow after becoming member of CU

1.8. Research Framework

This research is about social and economic effects if Tajikistan enters CU. To make the research more specific Research Questions were formulated base on the Jacob Viner's theories on trade creation and trade diversion. In addition, this research will analyze the social effect of CU by means of migration. To better explain this effect, neo-classical theory on migration will be used.

1.9. Research Questions

After analyzing literature review and research gap following Research Questions were formulated.

Main Question:

What are the possible social and economic consequences if Tajikistan enters Customs Union?

The main question can be divided in the following sub questions:

1. What are the effects of CU on Trade?
2. How CU does affect Foreign Direct Investments?
3. How CU influences migration?

The research questions will be answered using primary and secondary data analysis. The objectives of the research are following:

1. Examine available literature on the topic;
2. Select the sample of countries for further analysis;
3. Analyzing countries that are already member of CU

2. METHODOLOGY

The chapter provides an overview of the research methods that was used in order to achieve the objectives of the research. First, the approach to research and the methods chosen are well described, since the choice is complemented. Secondly, the data collection part contains a description of the necessary data, as well as data collection methods. Finally, the reliability of the results and limitations associated with the study is discussed.

2.1. Problem Statement

Economic integration is a historically established community that has evolved over the years. It is a broad interstate association that has its organizational structure. Between the participants of integration, a deeper division of labor is carried out, an intensive exchange of goods, services, capitals, and labor is conducted. Customs Union is the second step of economic integration. Customs Union within EEU is very young if we compare EU thus this topic is not learned so deeply. This paper was aimed to analyze EEU and its impacts on trade by means of import and export; on investments by means of FDI and on labor market by means of migration.

As it was already mentioned above the objectives of this paper are:

1. Examine available literature on the topic;
2. Select the sample of countries for further analysis;
3. Analyzing countries that are already member of Customs Union;

2.2. Methodology and organization

The paper will cover all members of CU of EEU. There are five states that are members of this union.

The results of this work will be applied. It means that the results of the paper have practical implementation. As this research mostly state related one can think that there will be just state implication but results of the paper have managerial implication. For example, the government of Tajikistan can use the result of this paper to propose policies. However, the result of this work can be used for local and international companies that conduct business in Tajikistan.

2.3. Case study method

The case study method through reports of past researches allows you to explore and understand complex issues. It can be considered a reliable method of research, especially when a holistic, in-depth analysis is required. The reason of using the case study method is the limitation of quantitative method that can not provide very deep analysis for social problems. The case study method gives you a chance to look to the problem from different angle. By using both quantitative and qualitative one can understand the process and the result of observation (Tellis, 1997).

This research method is used when the research questions "How?" and "Why?" not "What?". As it allows to better understand a specific problem and offer advanced solutions (Cameron & Price, 2009).

2.3.1. Advantages and Disadvantages of Case Study

Data are most often considered in the context of its use (Yin, 1984), that is, in the situation in which the activity takes place. One can use both qualitative and quantitative analysis. Detailed qualitative reports, often created in case studies, help not only to explore or describe data in real life, but also help to explain the complexity of real-life situations that can not be captured by experimental or research studies.

Case studies are often blamed for the lack of rigor. Yin (1984: 21) notes that "too many times the investigator was careless and allowed ambiguous evidence or preconceived views to influence the direction of conclusions. In addition, it provides very little basis for scientific generalization, since they use a small number of subjects, some of which are conducted with only one subject. Usually the question arises: "How can you generalize one case?" (Yin, 1984: 21). Too long, difficult to conduct and producing a massive amount of documentation (Yin, 1984).

2.4. Research object and data collecting method

The research objects will be countries that are members of EEU. There will be qualitative method of analysis. Kyrgyzstan, Kazakhstan and Belarus will be taken as the sample. As these countries are already member of EEU, it will be easier to calculate any change in economic and labor market in this countries. Three major divisions will be analyzed: trade, investment and labor market. To calculate trade, I need to check the differences trade balance. Investments will be evaluated by means of FDI. Paper will examine if investment inflow increased when country became member of EEU. And the last but not least is labor market. I want to check migration inflow and outflow before and after the EEU. After finishing parts with findings I want to write about possible scenario if Tajikistan enters EEU.

3. RESULTS OF EMPIRICAL STUDY

This chapter provides the case analysis about countries that became a member of Eurasian Customs Union. First, there is information about countries and their first steps as a member of CU. Second, characteristics of trade and the changes in trade balance after entering CU. Third, features of foreign direct investments and the difference before and after CU. Last, about labor market and effect on migration.

All analysis is based on data that were obtained from official statistical website of countries and open data from World Bank. There are three countries that were analyzed and the order is following:

- Kyrgyzstan
- Kazakhstan
- Belarus

The reasons why these countries were selected as a sample cases are following:

- Kyrgyzstan and Belarus joined CU as the last members
- Kyrgyzstan is a neighboring country and has very similar economy with Tajikistan
- Kazakhstan was one of the three members which established CU and the effects of entering to the union should be identified better

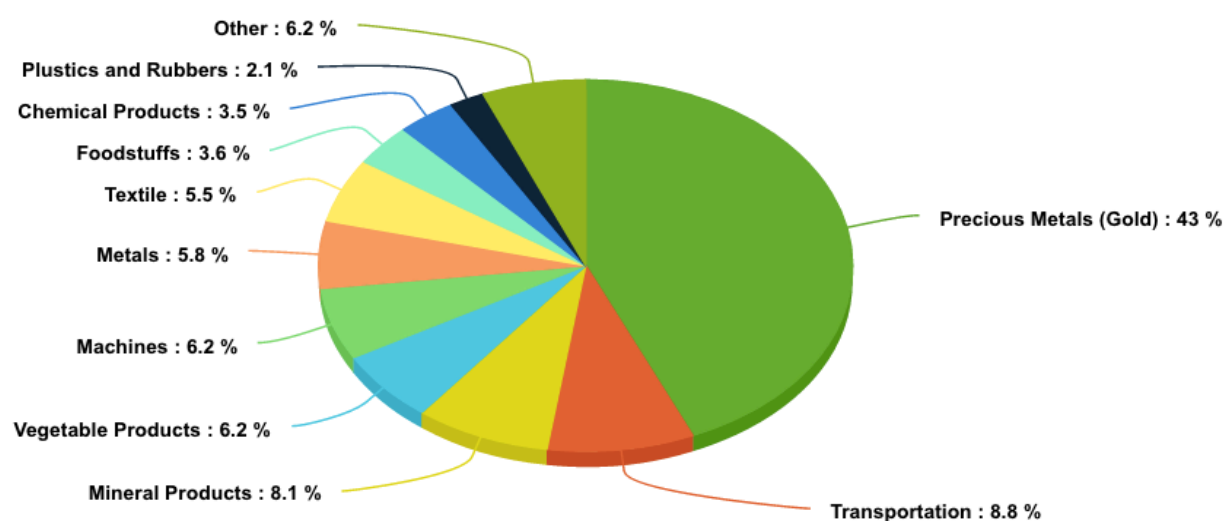
3.1. Case study: Kyrgyzstan after entering Customs Union

In August 12, 2015 Kyrgyzstan became a full member of the Eurasian Economic Union. Thanks to the country's entry into the EEU, the customs control on the border of Kyrgyzstan with the rest of the countries of the association was canceled. That meant new investment opportunities and prospects for implementing large infrastructure projects, especially in the areas of energy, transport and agriculture. Citizens of Kyrgyzstan got the right to work in any state of the union on general terms and are not considered as "labor migrants". In particular, they are exempted from the need to formalize registration in Russia within a month from the time they enter the country. In addition, the education documents issued in Kyrgyzstan is recognized in all countries of the Union. In addition, the work experience of Kyrgyz workers in Russia will be included in the total length of service for social security purposes, they are entitled to join trade unions on an equal footing with Russian citizens

Almost two years past and below there is analysis of the changes that happened in Kyrgyzstan. Three indicators such as trade, investment and labor were analyzed and the results are presented below.

3.1.1. Trade

According to Economic Complexity Index (ECI) Kyrgyzstan is 141st largest export economy in the world and number 69th most complex economy. The trade balance of the country is negative thus it imports more than exports. Figure 1 show the main products that Kyrgyzstan exports. The major export product is Precious Metal and almost 90% of it is gold. Next goes transportation, mineral products, vegetables, machines, metals and textile. Top 5 export destinations from Kyrgyzstan in 2016 were Switzerland, Russia, Kazakhstan, Uzbekistan, and China.



*Figure 1 Exports by products. 2016 Kyrgyzstan
Source: Trading Economics*

The next step is to analyze the trade between Kyrgyzstan and CU members before and after joining the union. The amount of exports within Custom Union starting from 2014 to 2016 is demonstrated Figure 2.

The Figure 2 shows the export from Kyrgyzstan to CU members before and after joining it. We can see that just after accession CU export decline to Kazakhstan but the next year it started increasing and got the previous level. In a case of Russia exports increase right after the joining but the growth is not stable. Overall the export to Russia is higher then it was before CU. However, exports to Armenia and Belarus decreased, the reasons can be the relocation of export to Russia and Kazakhstan.

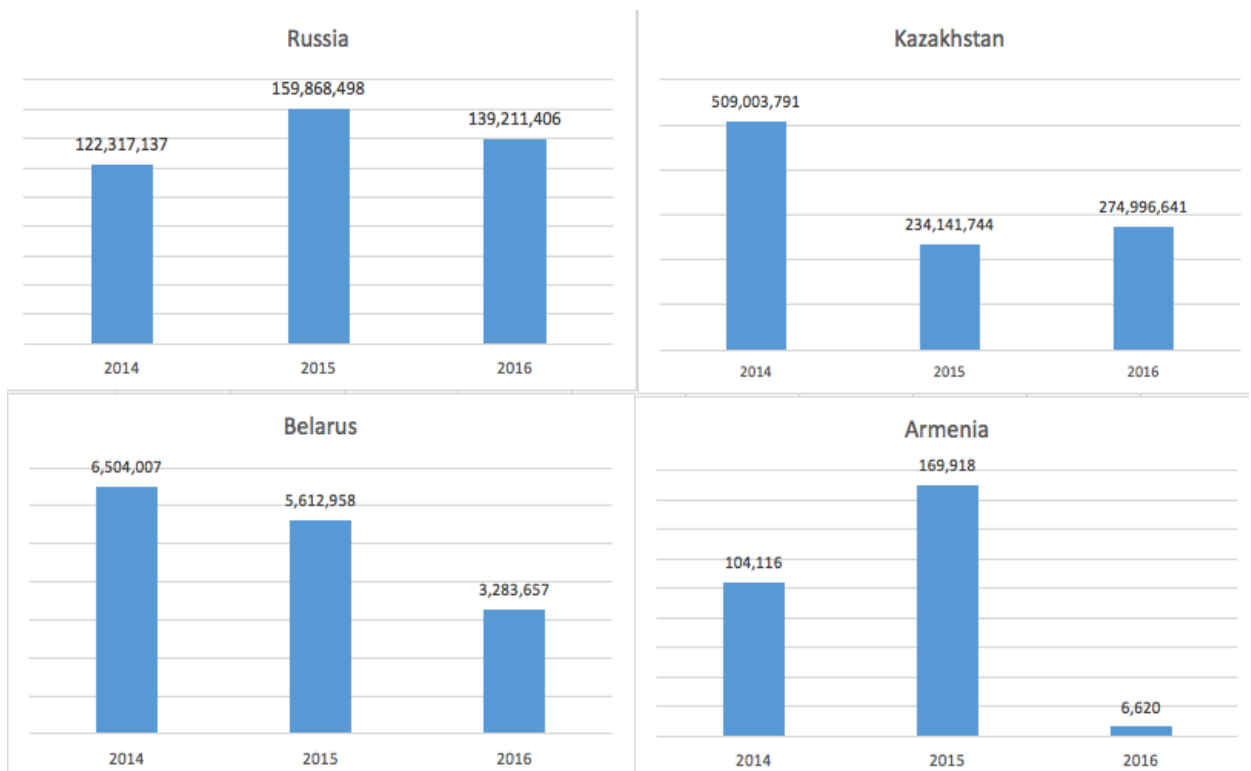


Figure 2 Exports within EEU Kyrgyzstan
Source: Eurasian Economic Commission

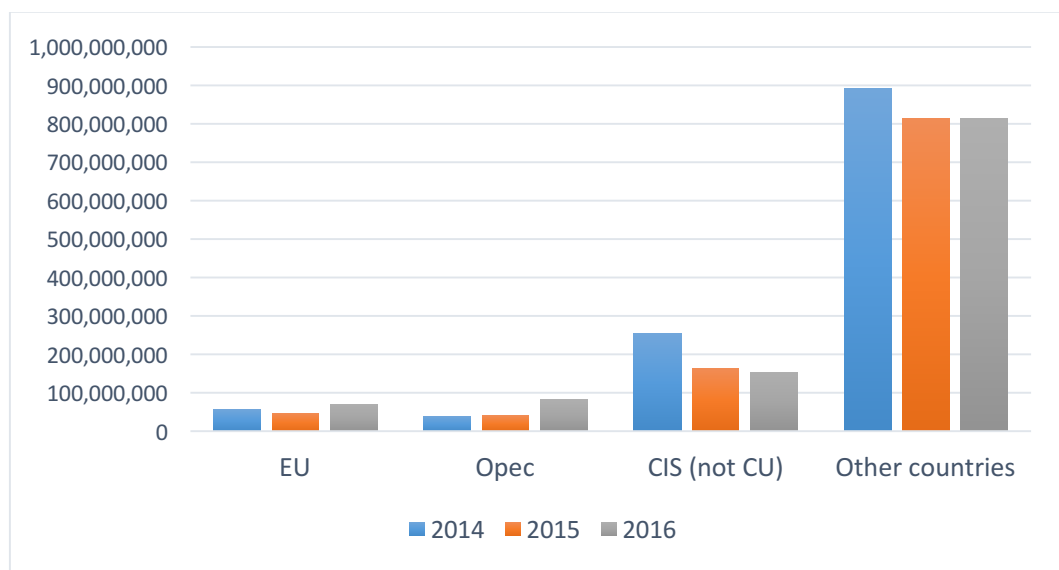


Figure 3 Export to third countries. Kyrgyzstan
Source: Eurasian Economic Commission

Figure 3 shows the export destination of Kyrgyzstan products. Overall the export to third countries decrease in 2015 by 14.1% but the next year 2016 it started rising by 5.2%. The same happened export to EU, as Kyrgyzstan joined CU in the August 2015 the export to EU countries declined by 14.6% but the next year it increased by 44.5%. The reason of the rise in export is Great Britanie that the export increase to this country by 2.8 times. From APEC countries the main export destination is China. Figure 3 show the rise of export and the main driver of it is

export to China that increase 2.2 times in 2016. However, trend of export to CIS countries that are not member of CU is negative. Export to other countries decline by 8.8% and remained the same in 2016. The main export destination from this category is Switzerland. Kyrgyzstan export gold to this country.

Figure 4 shows the main products that are imported by Kyrgyzstan. Main imports are mineral fuels, oil, distillation product then machinery, nuclear reactors and boilers.

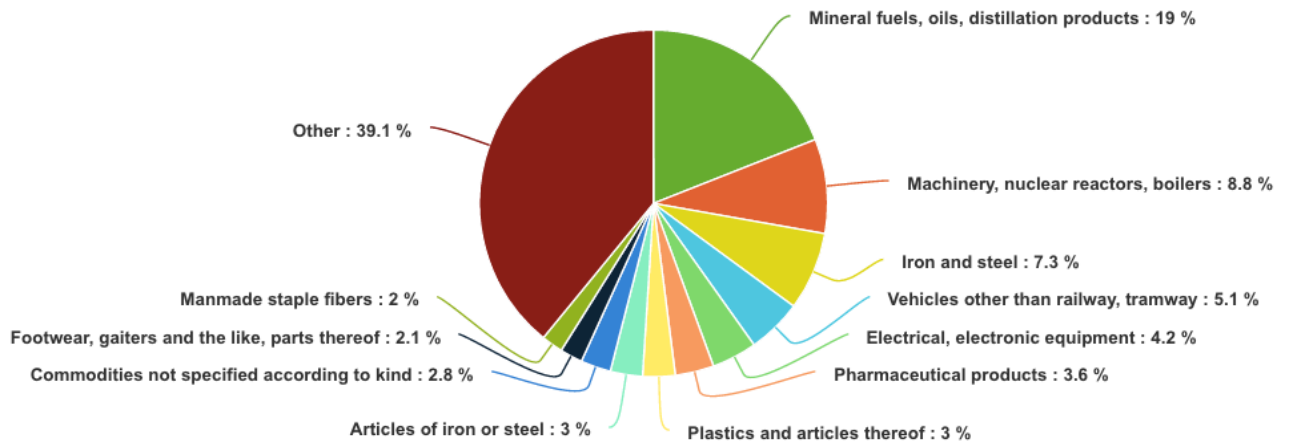


Figure 4 Imports by products, 2016 Kyrgyzstan
Source: Trading Economics

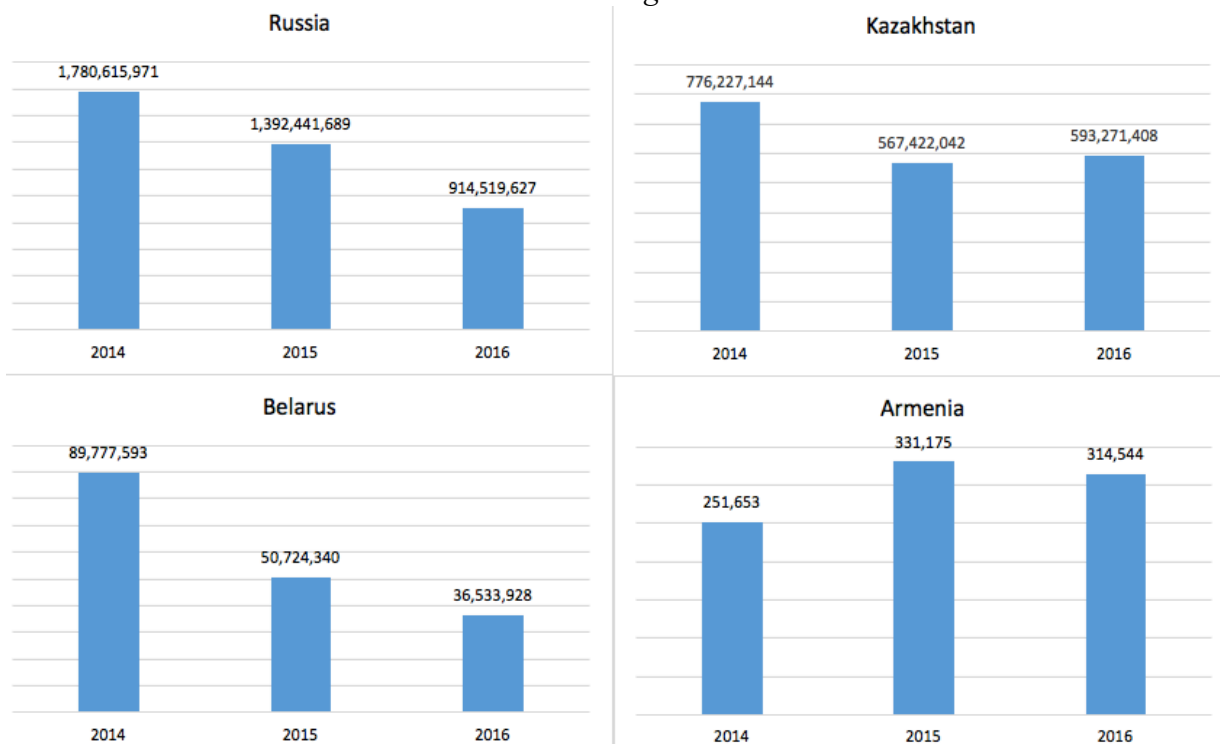


Figure 5 Imports within EEU Kyrgyzstan
Source: Eurasian Economic Commission

Figure 5 shows import of Kyrgyzstan within Customs Union. Overall trend is negative except import from Kazakhstan that decrease by 27% during 2015 and increased by 5% by 2016.

Import from Russia decreased from 2014 till 2016. In 2015 and 2016 it decreased by 22% and 34% consequently. Import from Belarus and Armenia decreased also.

Figure 6 shows the import destination of Kyrgyzstan. Overall the import from third countries decrease in 2015 by 33% but the next year 2016 it started rising by 15%. The same happened to import from EU, it declined by 56% and 29% in 2015 and 2016. From APEC countries the main imports come from China, USA and Japan. Figure 6 shows the rise of import in 2016 by 30% and the main driver of it is China that increase by 42%. However, trend of import from CIS countries that are not member of CU is negative and shows decline by 31% and 26% in 2015 and 2016 consequently. Import to other countries decline by 50% in 2015 and increased by 7% in 2016. The reason of the decline in 2015 was the huge decline of imports from United Arab Emirates, Turkey and Switzerland.

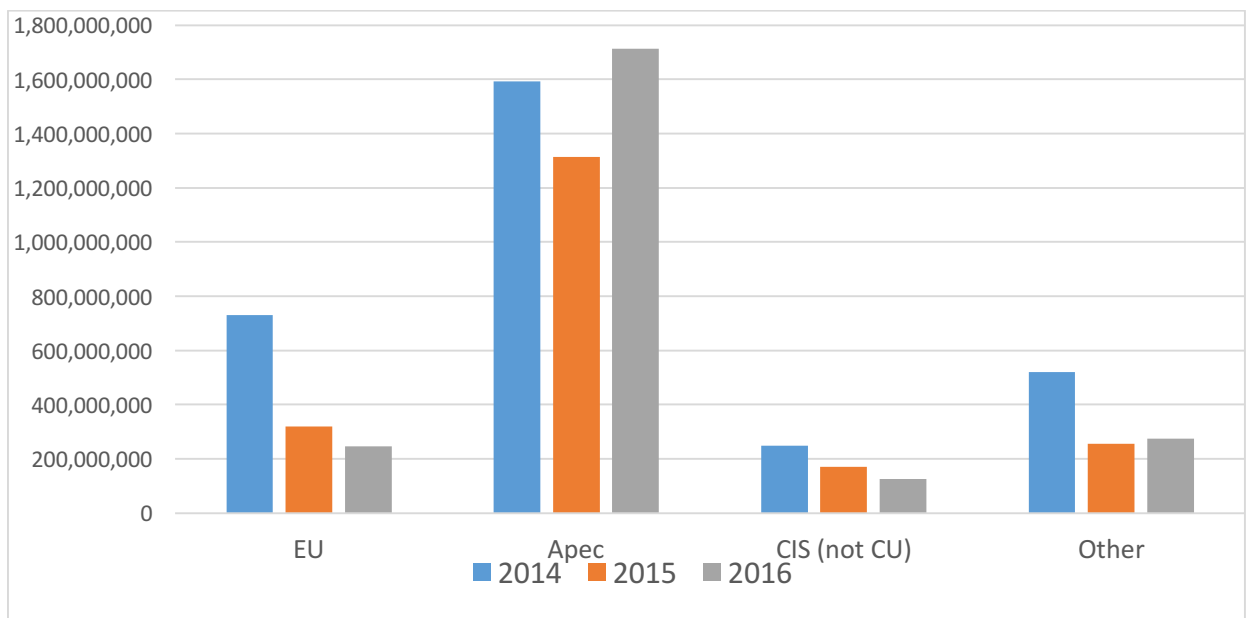


Figure 6 Imports from other countries. Kyrgyzstan
Source: Eurasian Economic Commission

The volume of mutual trade of the republic with the member states of the CU in January 2017 Amounted to 143.6 million US dollars and compared with January 2016 decreased by 7.2 %. At the same time, exports decreased by 6% and import receipts, on the contrary, have increased by 14,1%. The largest share of mutual trade with members of the CU fell on:

1. Russia 65%
2. Kazakhstan 34.2%

Table 5 Change of mutual trade of Kyrgyzstan with Russia and Kazakhstan between January-February 2016 and 2017
Source: National Statistical Committee of Kyrgyzstan

Russia	Export	Increased	<ul style="list-style-type: none"> • by 2.6 times - beans and dried vegetables • by 23.8% - dried fruits • by 1.2% - footwear
		Decreased	<ul style="list-style-type: none"> • by 10.1% - clothes and clothing accessories.
	Import	Increased	<ul style="list-style-type: none"> • by 1.8 times - dairy products • by 2.5 times - wood products • by 32.8% - ferrous metals, • by 22.5% plastic products
		Decreased	<ul style="list-style-type: none"> • by 44.7% - vegetable oils by • by 39.4% - confectionery products • by 49.8 % - soap products
Kazakhstan	Export	Increased	<ul style="list-style-type: none"> • by 1.6 times - milk and cream condensed
		Decreased	<ul style="list-style-type: none"> • by 2.3 times - vegetables
	Import	Increased	<ul style="list-style-type: none"> • by 2.7 times - confectionery products • by 2.4 times - paper, cardboard and paper products • by 1.8 times - soap products
		Decreased	<ul style="list-style-type: none"> • by 7,1 times Carbonated mineral water • by 48,1% - vegetable oils

We can see from the figures above that after 2013 the trade between most countries decrease due to the oil price crisis. In order to remove the effect of oil price to imports and exports Chain Index and Base Index analysis were conducted. The meaning of this index is that: for one dollar of Kyrgyzstan exports to the EU, how does Kyrgyzstan export changes to Russia. By doing this we remove the influence of the cycle and oil prices. We compare the dynamics of one country to another for exports and imports. Despite the absolute decrease of trade, the structure of trade is changing. Formula of the chain and base analysis:

Period	0	1	2	3	4	5
Index	y_0	y_1	y_2	y_3	y_4	y_5
Base Index		$\frac{y_1}{y_0}$	$\frac{y_2}{y_0}$	$\frac{y_3}{y_0}$	$\frac{y_4}{y_0}$	$\frac{y_5}{y_0}$
Chain Index		$\frac{y_1}{y_0}$	$\frac{y_2}{y_1}$	$\frac{y_3}{y_2}$	$\frac{y_4}{y_3}$	$\frac{y_5}{y_4}$

Tables 6 Chain and Base indexes of exports from Kyrgyzstan to KZ/EU and RU/EU

Years	2014	2015	2016
KZ/EU	868%	467%	380%
Chain index	100%	54%	81%
Base Index (2014 = 100%)	100%	54%	44%
Years	2014	2015	2016
RU/EU	209%	319%	192%
Chain index	100%	153%	60%
Base Index (2014 = 100%)	100%	153%	92%

According to the Table 6 where we compared the export from Kyrgyzstan to Kazakhstan compare to EU the chain index decreased to 54% in 2015 and to 81% in 2016. It means that in one dollar exports to EU from Kyrgyzstan export to Kazakhstan decreased to 54 cents in 2015 and 81 cents in 2016. The same index where we compared exports from Kyrgyzstan to Russia compare EU showed that in 2015 export to Russia was higher by 15% but lower by 40% in 2016. It means that in 2015 for \$1 exports from Kyrgyzstan to EU exports to Russia was \$1.15 but in 2016 exports from Russia was \$0.60 compare to \$1 to EU.

The base index showed that compare to 2014 exports to Kazakhstan decreased by 46% in 2015 and by 56% in 2016 compare to exports to EU. In the case of Russia and EU in 2015 the exports increased by 53% and decreased by 8% in 2016 compare to 2014.

Tables 7 Chain and Base indexes of Imports to Kyrgyzstan from KZ/EU and RU/EU

Years	2014	2015	2016
KZ/EU	106%	177%	240%
Chain index	100%	167%	135%
Base Index (2014 = 100%)	100%	167%	226%
Years	2014	2015	2016
RU/EU	244%	435%	370%
Chain index	100%	178%	85%
Base Index (2014 = 100%)	100%	178%	152%

Table 7 where we compared the import from Kyrgyzstan to Kazakhstan compare to EU the chain index increased by 67% in 2015 and 35% in 2016. It means that in one dollar exports to EU from Kyrgyzstan export to Kazakhstan decreased increased to \$1.67 in 2015 and \$1.35 in 2016. The same index where we compared imports from Kyrgyzstan to Russia compare EU showed that in 2015 export to Russia was higher by 78% but lower by 15% in 2016. It means

that in 2015 for \$1 exports from Kyrgyzstan to EU exports to Russia was \$1.78 but in 2016 exports from Russia was \$0.85 compare to \$1 to EU.

The base index showed that compare to 2014 imports from Kazakhstan increased by 67% in 2015 and by 126% in 2016 compare to exports to EU. In the case of Russia and EU in 2015 the exports increased by 78% and 52% in 2016 compare to 2014.

3.1.2. Investments

Facilitating FDI has been a key priority of current and past administrations. In 2012, the Government enacted an anti-corruption plan in order to improve the country's business climate (although, corruption remains a problem). FDI flows reached USD 310 million in 2014, a decrease compared to 2013. The data for 2015 are from January to September. During this time, Kyrgyzstan received USD 521 million worth of FDI flows, a net increase compared to 2014. This is in large part due to infrastructure investments from Russia and China.

China invested in several significant projects in 2013 (gas pipeline, renovation of a steam-generating station, highway, refinery) and, in 2014, it invested USD 70 million in the construction of a cement plant. However, Kyrgyzstan is involved in an ongoing dispute with the Canadian group Centerra Gold over control of the Kumtor gold mine. In 2015 Kyrgyzstan's parliament threatened to nationalize the mine if an agreement was not reached within a month. As of 2016, no agreement has yet been reached on this issue. Lastly, in the 2016 Doing Business report published by the World Bank, the country ranked 67th out of 189 countries, which represents significant progress over the past years.

The manufacturing and finance sectors attract the majority of FDI in the country. Kyrgyzstan's main investors are Germany, Great Britain, Russia, Canada and China.

The inflow of foreign direct investment in 2016 in comparison with 2015 decreased by 2.4 times and amounted to \$ 654.8 million.

The bulk of foreign direct investment (more than 86%) was directed to financial intermediation and insurance, exploration, manufacturing enterprises, and supply (supply) with electricity, gas, steam and air conditioning. At the same time, the volume of investments directed to manufacturing enterprises fell by 3.6 times, the sphere of financial intermediation and insurance - by 2.3 times, provision (supply) with electricity, gas, steam and air conditioning - by 1.9 times, Exploration - 1,7 times.

Among the countries outside the CIS, China was the main investor, the amount of which was reduced by 39%. Along with this, the volume of direct investments from Great Britain, Canada and Turkey decreased significantly, which, on the whole, led to a 2.5-fold decrease in investments from non-CIS countries.

The volume of incoming foreign direct investment from the CIS countries in comparison with 2015 decreased by 2.2 times due to their significant reduction from Russia and Belarus. At the same time, the inflow of investments from Kazakhstan increased by 8.9%.

Table below shows the top countries that invested to Kyrgyzstan during 2016. The biggest investors were China and Russia. The overall share of these countries to FDI of Kyrgyzstan was 81%.

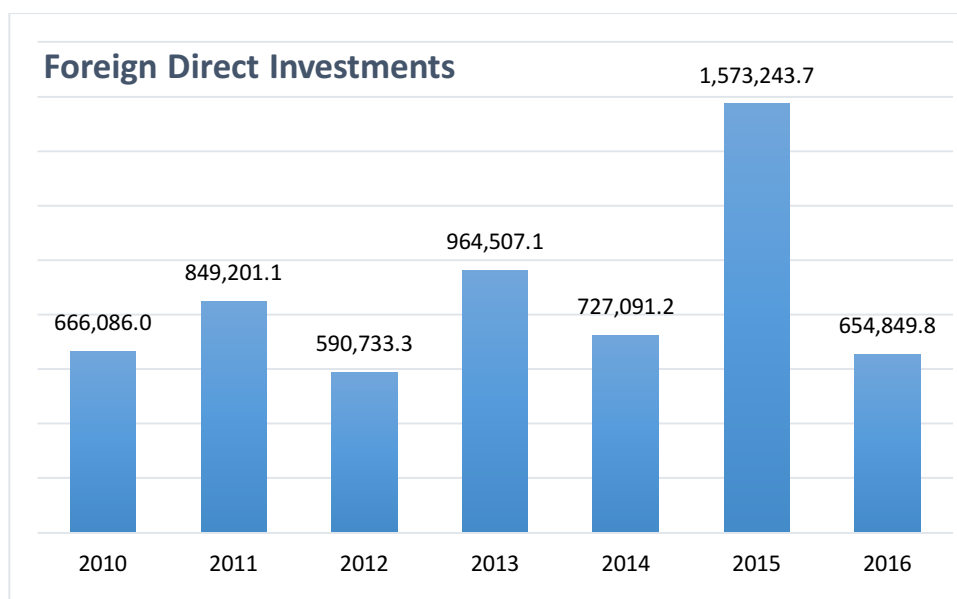


Figure 7 FDI inflows 2010-2016 Kyrgyzstan
Source: National Statistical Committee of Kyrgyzstan

After joining CU FDI in Kyrgyzstan decreased but to analyzed the effect in FDI we need to wait at least for 5-7 years. FDI decreased because of major investors like China and Russia decreased investments. Investments from China decreased by 40% and from Russia by 53%.

3.1.3. Migration

One of the vital factors entering Kyrgyzstan to CU was migrants. The economy of country is highly dependent on money transferring by migrants from Russia and Kazakhstan. Establishing CU makes the labor migration difficult because a migrant had to buy special working permission patents in order to work legally in the territory of CU. This situation forced migrants to work illegally or pay from \$60 to \$150 monthly. And the documentation costs about \$400. Thus according to Table 6 the number of migrants increased by 30 thousand in 2015 and 34 thousand in 2016. Entering CU increased the migration outflow from Kyrgyzstan. The possible consequences of labor migration are described in Figure 8.

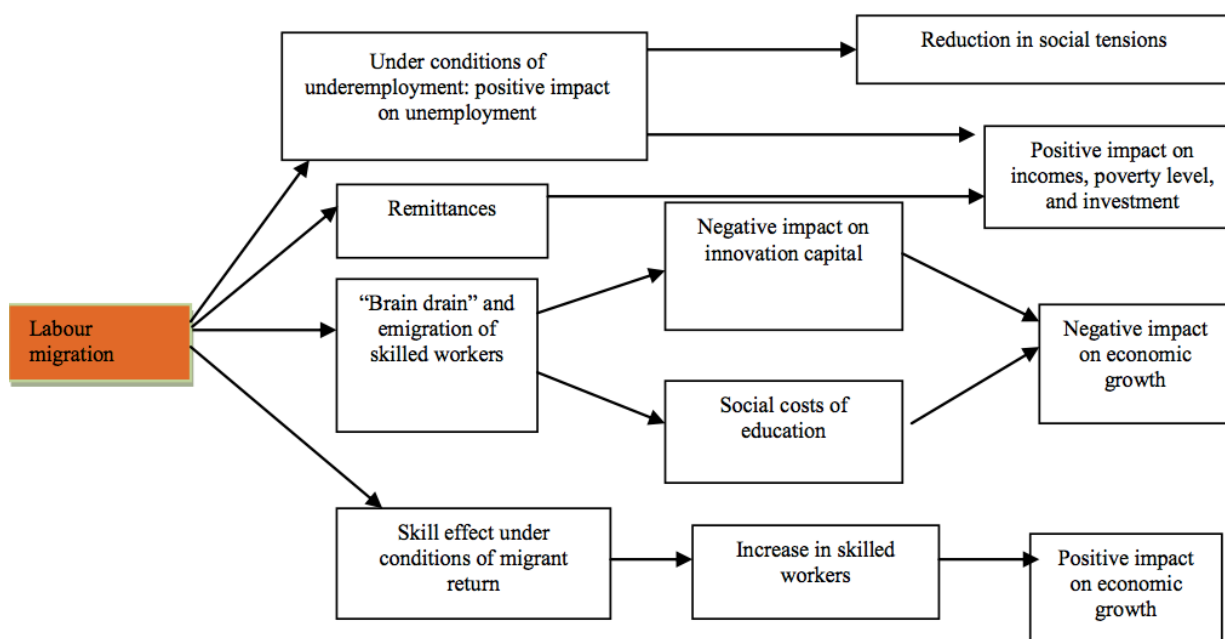


Figure 8 The impact of migration on the labor-sending country market

As it was mentioned the economy of Kyrgyzstan depends on remittance and joining CU had positive impact on money transfer. After oil price crisis and currency depreciation working in Russia became less attractive with the cost patents and lower salary in dollar amount. Money transfer decreased by 47% in 2015 (Table #)

Table 8 Change in transfer of money

Source: National Statistical Committee of Kyrgyzstan

Change in transfer of money from Russia 2014-2016 in mln.			
Year	2014	2015	2016
Money transfer	\$2,062.00	\$1,083.00	\$1,700.00
Change		-47%	57%

In 2016 after a year in CU transfer of money increased by 57% with amount of \$1.7 billion that made up 27% of GDP of Kyrgyzstan that it highest proportion among CIS countries. In a word CU increase migration outflow thus increase the total welfare of population of sending country.

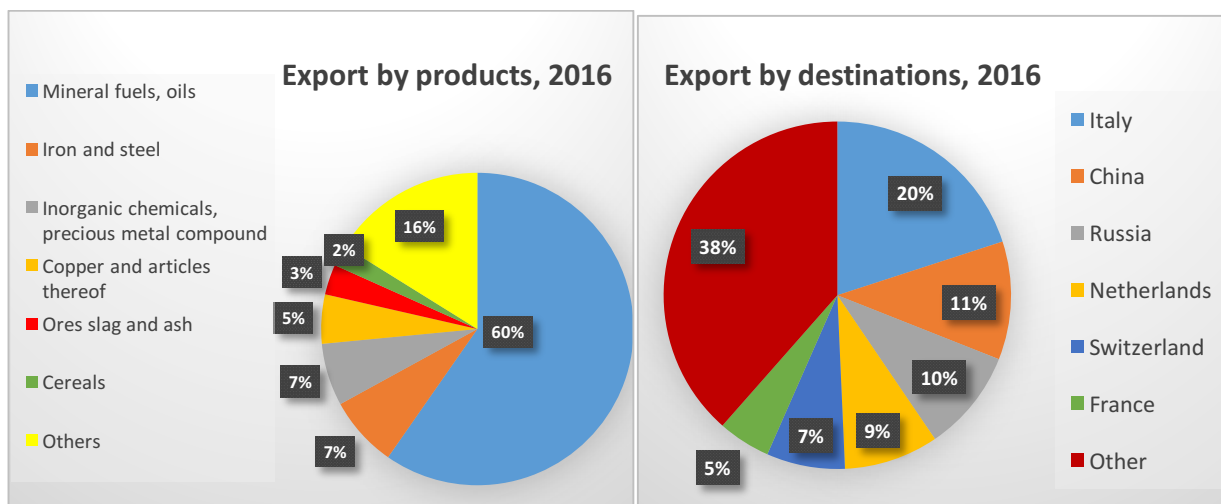
3.2.Case study: Kazakhstan after entering Customs Union

Kazakhstan was one of the initiator in the creation of Customs Union and later Eurasian Economic Union. The president of Kazakhstan Nursultan Nazarbayev was interested in such integrations after collapsing Soviet Union. In 1994 Nazarbayev was interested in creating a Free Trade agreements with former soviet countries. His idea was not understood and underestimated by the politicians of the countries of the former USSR, but today it was embodied in real life and officially confirmed by the Treaty. The concept of creating a new integration Eurasian

association, proposed by the President of Kazakhstan Nazarbayev, was based on a common history, mutual economic attraction, close interconnection of cultures and the closeness of human aspirations, which would eventually give the people a chance to build a new type of multilateral and interstate relations.

3.2.1. Trade

In this part there will be analysis of trade after creation of CU and how it effected the overall trade.



*Figure 8 Export by products and destinations, 2016 Kazakhstan
Source: Trade Economics*

According to Figure 8 the main export of Kazakhstan is mineral fuels and oil that was 60% of all exports in 2016. Iron and steel with inorganic chemical and precious metal compound both have 7% of the total export. The biggest share of Kazakhstan export goes to Italy up to 20% of all export in 2016. The main export to Italy were crude oil, oil products and fuel for the amount of \$7.47 billion. Other major export destinations were China, Russia, Netherland, Switzerland and France.

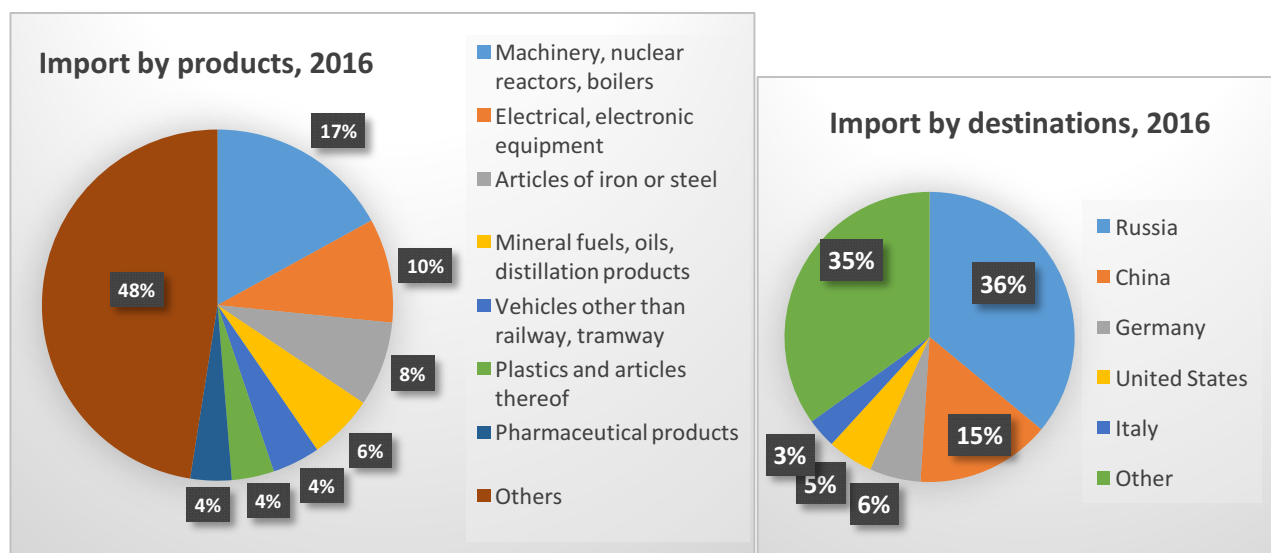


Figure 9 Import by products and destinations, 2016 Kazakhstan
Source: Trade Economics

Kazakhstan imported mostly machinery, nuclear reactors and boilers that made 17% of all imports in 2016. Other imported products were electrical and electronic equipment, articles of iron and steel, oil distillation products and etc. The major import destination was Russia with 36% share then China, Germany, USA and Italy.

Next step is to analyze what how export with Belarus, Russia and future members changed right after creation of CU. Figure 10 shows export to CU countries from 2010 to 2016. As Russia is in top 3 export destination lets check how entering CU effected export. In 2011 the amount of export to Russia was approximately \$6.7 billion. As CU stated operation from July 1 2011 let's see how export changed. In 2012 export to Russia decreased by 12% and by 4% compare to 2012. In 2014 export increased by 9% but the next 2 years it continued decreasing by more than 25%. So if we compare export to Russia in 2011 before entering CU and 2016 the export decreased by 38%.

The same situation we can see export to Belarus. It stated decreasing after creation of CU and the export to Belarus between 2011 and 2016 decreased by 70%.

As Kyrgyzstan is a neighbor of Kazakhstan the trade between them is very developed. As it was mentioned Kyrgyzstan joined CU in August 2015 and the Figure shows that export had positive trend from 2010 to 2014. Export increased by 4%-5% each year. Export declined by 26% in 2015 and 27% in 2016. The same was with Armenia.

This paper is not aimed to analyze the reasons of such changes in trade but just to show how CU effect the trade.

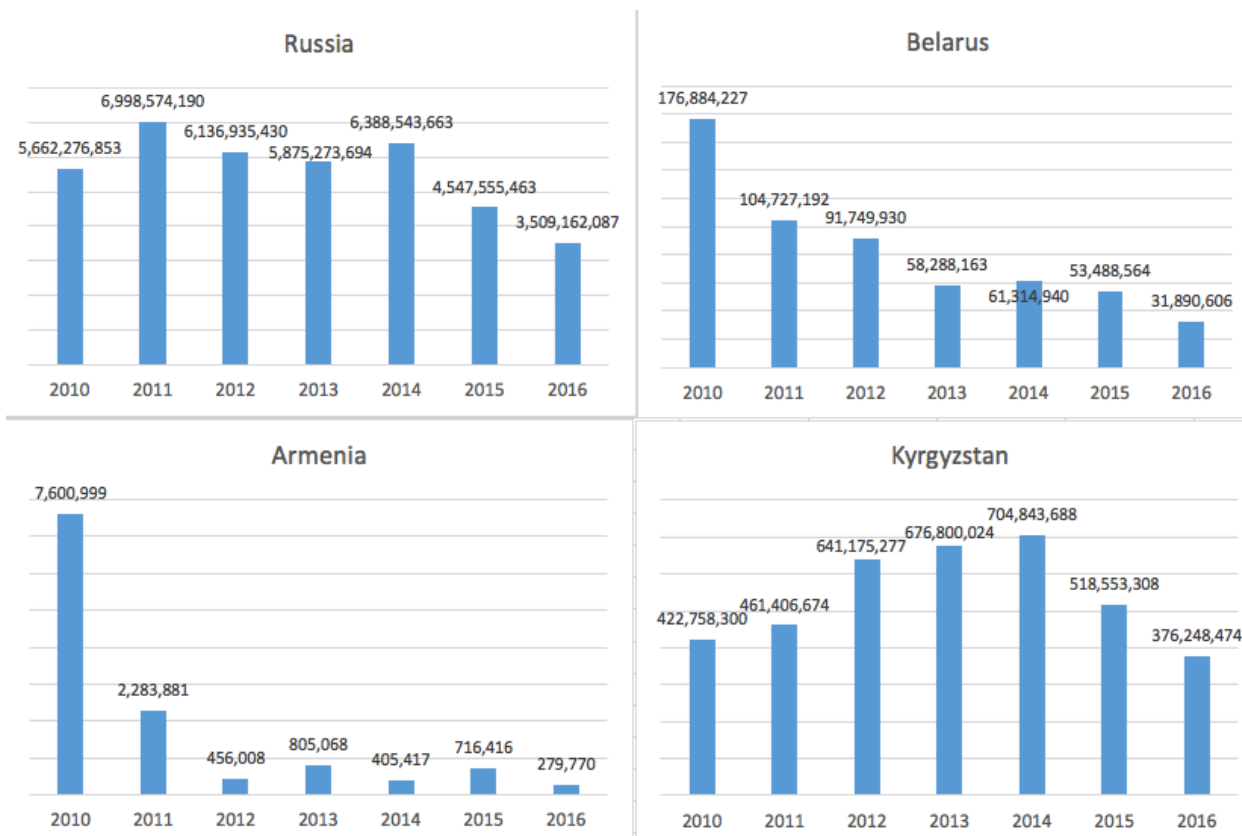


Figure 10 Export to CU members Kazakhstan
Source: Eurasian Economic Commission

After analyzing change in trade between CU members let's check how the entering CU effect the export from Kazakhstan to other countries. In Figure 11 I divided export to 4 regions: EU, OPEC, CIS countries that are not member of CU and other countries. If we take export to EU we can see that even after joining CU export to EU continue growing. Its all because CU mostly effects import by means of Common External Tariffs.

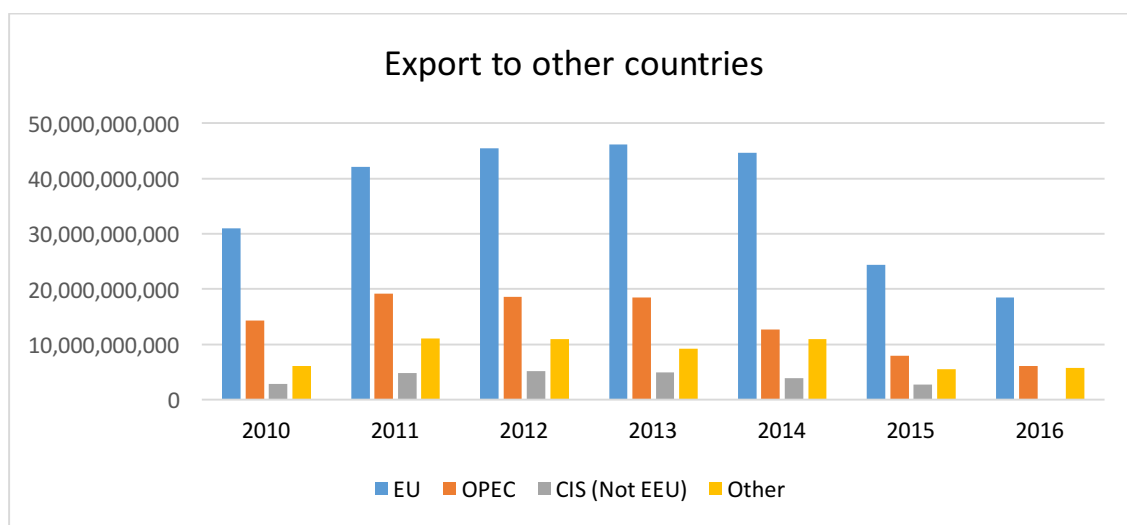


Figure 11 Export to other countries Kazakhstan
Source: Eurasian Economic Commission

Export to other regions also was increasing till 2015. Sudden decline can be the reason of falling oil price and depreciation of local currency.

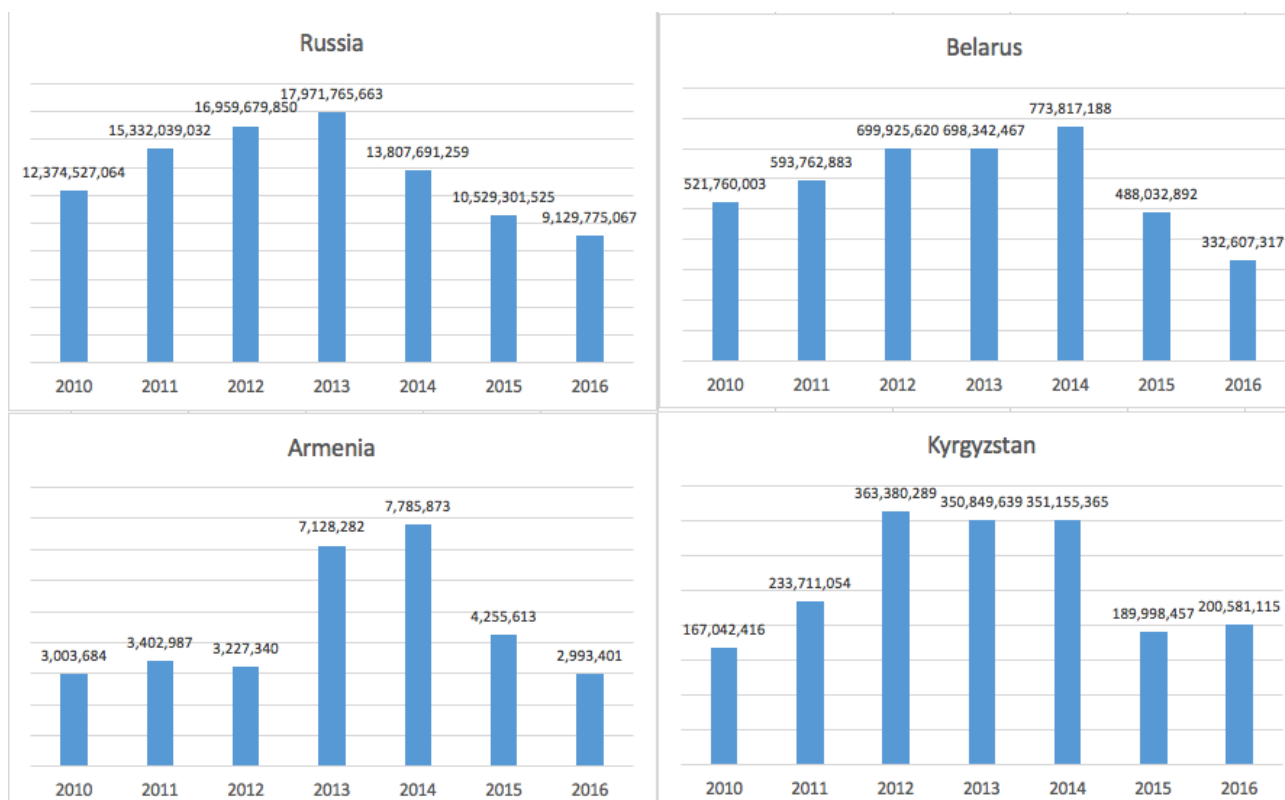


Figure 12 Import from CU members Kazakhstan
Source: Eurasian Economic Commission

Figure 12 shows import from CU members in the periods 2010-2016. Let's start with effect of CU on import from Russia. In 2010 the import from Russia amounted to more than \$12 billion and it stated increasing after Kazakhstan joined CU. The average percentage increase in import from Russia was 13% from 2011 till 2014.

CU also positively affected import from Belarus because the average increase was 11% from 2011 till 2014.

Despite Kyrgyzstan became member of CU in 2015, import from this country was increasing by average 23% each year. Them same was import from Armenia.

The overall conclusion from Figure 12 is that joining CU increased import from member countries.

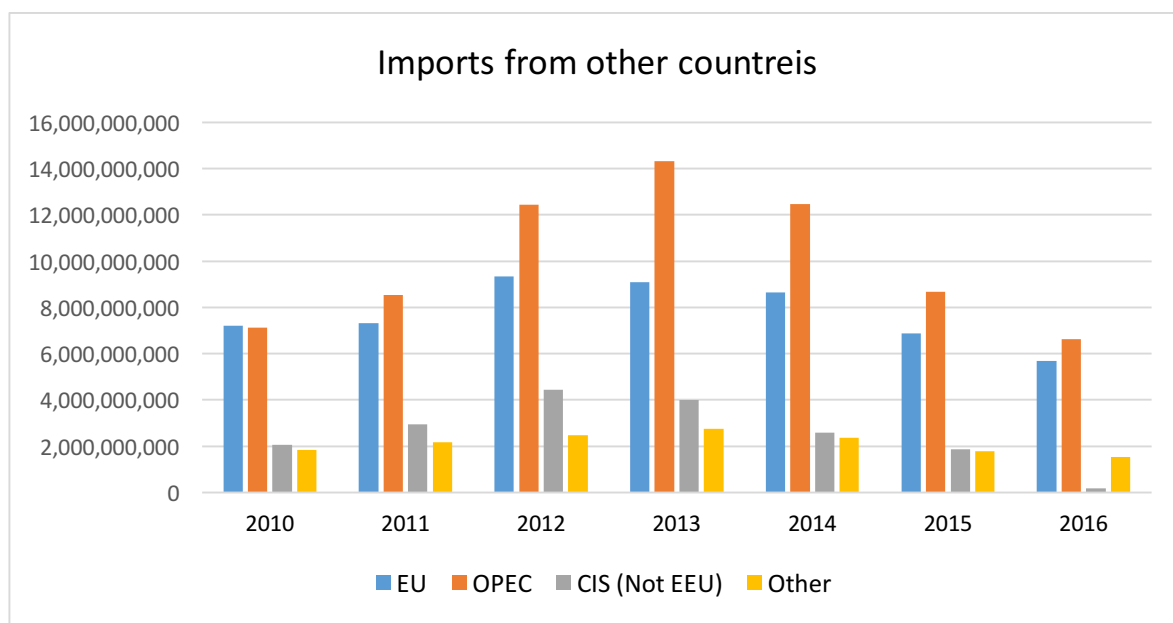


Figure 13 Import from other countries Kazakhstan
Source: Eurasian Economic Commission

Figure 13 shows the import from other countries. As the biggest import destination is China and it is related to OPEC division we can see that import from there was increasing until 2014 and the average growth was 17%. Here we can notice the same trend from EU, CIS and other countries that all imports were increasing until 2014 and the reason of this declining is not CU but the oil price crisis and depreciation of local currency up to 70% in 2015-2016.

Let's check how trade changed by using Chain and Base Indexes. As it was mentioned these indexes remove the change in oil price and show change in exports and imports.

Table 9 Chain and Base indexes of Exports from Kazakhstan to RU/EU and RU/OPEC

Years	2010	2011	2012	2013	2014	2015	2016
RU/EU	18%	17%	14%	13%	14%	19%	19%
Chain index	100%	91%	81%	94%	112%	130%	102%
Base Index (2010 = 100%)	100%	91%	74%	70%	78%	102%	104%
Years	2010	2011	2012	2013	2014	2015	2016
RU/OPEC	18%	17%	14%	13%	14%	19%	19%
Chain index	100%	91%	81%	94%	112%	130%	102%
Base Index (2010 = 100%)	100%	92%	83%	80%	127%	144%	144%

From the previous figure we can see that changes in exports and imports and almost all of them indicators started declining in 2014. The overall trade decreased because of the oil price crisis. In order to remove the effect of oil price Chain and Base analysis were conducted. In table 9 and 10 chain index shows the change in one-dollar exports/imports from Kazakhstan to Russia

and EU. Table 9 shows the export from Kazakhstan to Russia and EU. So what this table shows to us: First, we can see that proportion of exports from Kazakhstan to Russia and EU that was 18% in 2010. It means exports to EU was five times bigger than to Russia. Second, as chain index shows exports without the effect of oil crisis we see that exports to Russia has positive trend. In 2014 exports from Kazakhstan to Russia increased by 12% compared to exports to EU. It means that in one dollar exports from Kazakhstan to EU, exports to Russia from Kazakhstan increased by 1 dollar and 12 cents. The same happened with exports from Kazakhstan to Russia and OPEC countries. After 2013 exports to Russia compared to OPEC countries increased by 12% and increased till the end of 2016.

Base index showed the change in exports from Kazakhstan to Russia, EU and OPEC countries. 2010 was taken as the base year and we calculated how exports changed after 2010 when Kazakhstan joined CU. In this analysis we also removed the effect of oil price crisis. Base index shows that exports to EU and OPEC countries were more compared to exports to Russia. However, the index changed in 2014 and from then Kazakhstan exports to Russia increased by 27% compared to OPEC countries and in 2015 by 2% compared to EU.

Table 10 Chain and Base indexes of Imports of Kazakhstan from RU/EU and RU/OPEC

Years	2010	2011	2012	2013	2014	2015	2016
RU/EU	172%	209%	181%	198%	160%	153%	160%
Chain index	100%	122%	87%	109%	81%	96%	105%
Base Index (2010 = 100%)	100%	122%	106%	115%	93%	89%	94%
Years	2010	2011	2012	2013	2014	2015	2016
RU/OPEC	174%	179%	136%	125%	111%	121%	138%
Chain index	100%	103%	76%	92%	88%	110%	114%
Base Index (2010 = 100%)	100%	103%	78%	72%	64%	70%	79%

The imports from Russia compared to EU to Kazakhstan was increasing and decreasing during six years according to chain index. But the difference is not significant. And the imports from OPEC countries compared to Russia was decreasing from 2010 till 2014 and started increasing in average by 10% and 14% in 2015 and 2016.

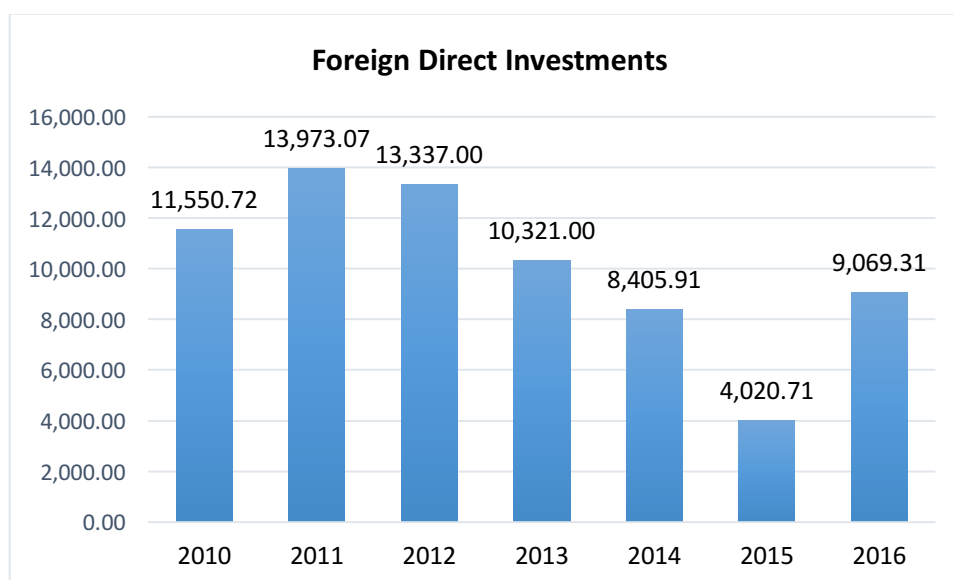
Base index showed increasing trend imports from Russia compared to EU from 2010 till 2013 and slightly decreased next three years. Imports according to base index decreased if we compare Russia and OPEC countries.

3.2.2. Investments

Regional conflicts, sanctions imposed on Russia, and negative growth prospects are holding back foreign investors from the region. However, since gaining independence, Kazakhstan has carried out a series of reforms aimed at liberalizing its economy and facilitating foreign investment.

Figure 14 shows the FDI inflow from 2010 till 2016. In 2015 investments decreased by 52% and it affected mostly mining and construction sectors. The main investing country to Kazakhstan is China. Beijing intends to develop a new "Silk Road" and is going to invest \$2 billion to develop projects in Kazakhstan. Kazakhstan also plans to attract foreign investor to finance oil exploration projects.

The oil and mining sectors remain the most attractive, as they concentrate more than half of FDI. Kazakhstan is the most successful developed country in Central Asia and increased its oil production by 3 times in past 10 years. The threat for FDI inflow into the oil sector is the sharpen decline in oil price. However, the FDI inflow is increasing in manufacturing sector.



*Figure 14 Foreign Direct Investments Kazakhstan
Source: Eurasian Economic Commission*

Figure 14 demonstrate that FDI inflow was steadily decreased by average 15% from 2011 till 2015 but in 2016 it increased by 1.2 time. So by this time we can not say that FDI will immediately increase after joining CU.

3.3. Case study: Belarus after entering Customs Union

Belarus was also one of the three countries which initiated CU. It was interested in integration with Russia because the major amount of imports and exports goes to Russia. Belarus has always actively participated in integration initiatives implemented within the CIS. It is a member of the free trade zone of the CIS countries and the EurAsEC free trade zone, and since

1995 it has been in a customs union with Russia. Following the signing on November 27, 2009 by the presidents of Belarus, Kazakhstan and Russia of the Agreement on the creation of the Customs Union of the three countries, it became a member of this regional association

3.3.1. Trade

The effects of entering CU on trade are demonstrated below.

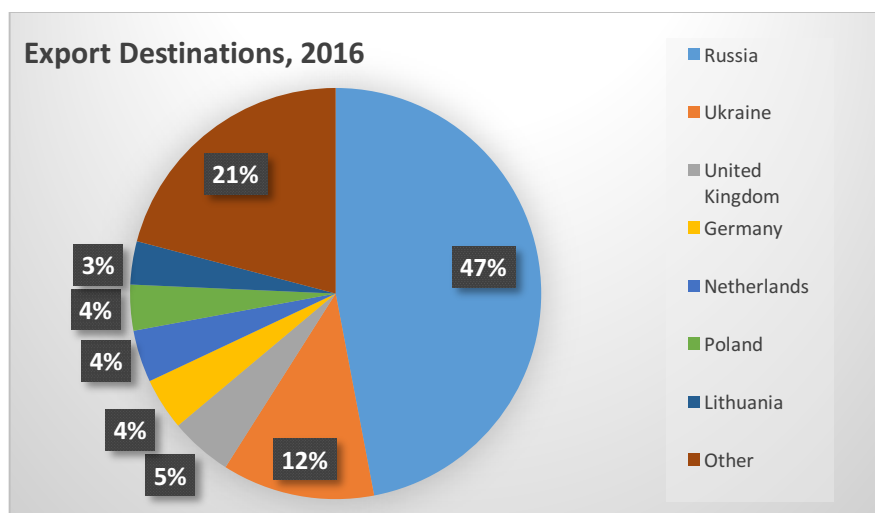


Figure 15 Export by destinations, 2016 Belarus
Source: Trade Economics

Table 11 Export by Products 2016 Belarus
Source: Trading Economics

Export by Products 2016	
Mineral fuels, oils, distillation products	24%
Fertilizers	12%
Dairy products, eggs, honey, edible products	9%
Vehicles other than railway, tramway	9%
Machinery, nuclear reactors, boilers	6%
Plastics and articles thereof	4%
Wood and articles of wood, wood charcoal	4%
Other	31%

According to Table 11 the main export of Belarus is mineral fuels and oil that was 24% of all exports in 2016. The second most exported products were fertilizers with 12% share. Dairy products, eggs, honey, edible products and vehicles other than railway, tramway both have 9% of the total export. Figure 15 shows that the biggest share of Belarus export goes to Russia up to 47% of all export in 2016. The main export to Russia were dairy products, eggs, honey, edible

products for the amount of \$1.8 billion. Other major export destinations were Ukraine, UK, Germany, Netherland, Poland and Lithuania.

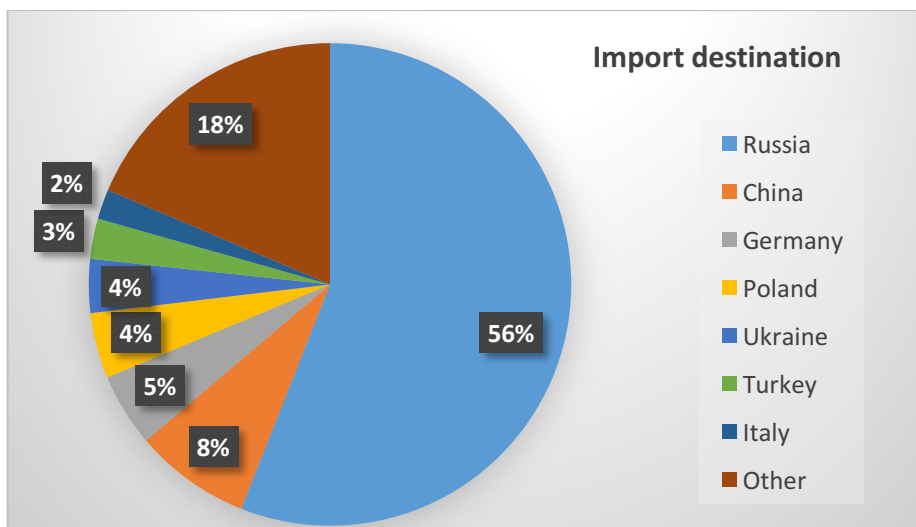


Figure 16 Import by destinations, 2016 Belarus
Source: Trade Economics

Table 12 Import by Products 2016 Belarus

Source: Trading Economics

Imports by Product	
Mineral fuels, oils, distillation products	32.1%
Machinery, nuclear reactors, boilers	11.1%
Electrical, electronic equipment	7.7%
Vehicles other than railway, tramway	5.8%
Plastics and articles thereof	5.8%
Edible fruits, nuts, peel of citrus fruit, melons	4.7%
Iron and steel	4.5%
Other	28%

Belarus imported mostly mineral fuels, oils, distillation products that made 32% of all imports in 2016 (Table 12). Other imported products were machinery, nuclear reactors, boilers and etc. According to Figure 16 the major import destination was Russia with 56% share then China, Germany, Poland, Ukraine, Turkey and Italy.

As in the previous case further analyses will be related to the change in export from Belarus to CU members. The Figure 17 demonstrates 6 years' exports from Belarus and the trend of exports. Starting with export to Kazakhstan we can find that after establishing CU in 2011, export to this country started increasing. In 2012 after one year of CU the export to Kazakhstan increased by 20% and the average growth from 2011 till 2014 was 9.5%. Exports to Russia also increased in the first year by 12% and the highest amount of \$16.8 billion was reached in 2013.

As the oil price crisis and depreciation of local currencies occurred in CU members the exports started declining from 2014 by the average 22% annually till 2016.

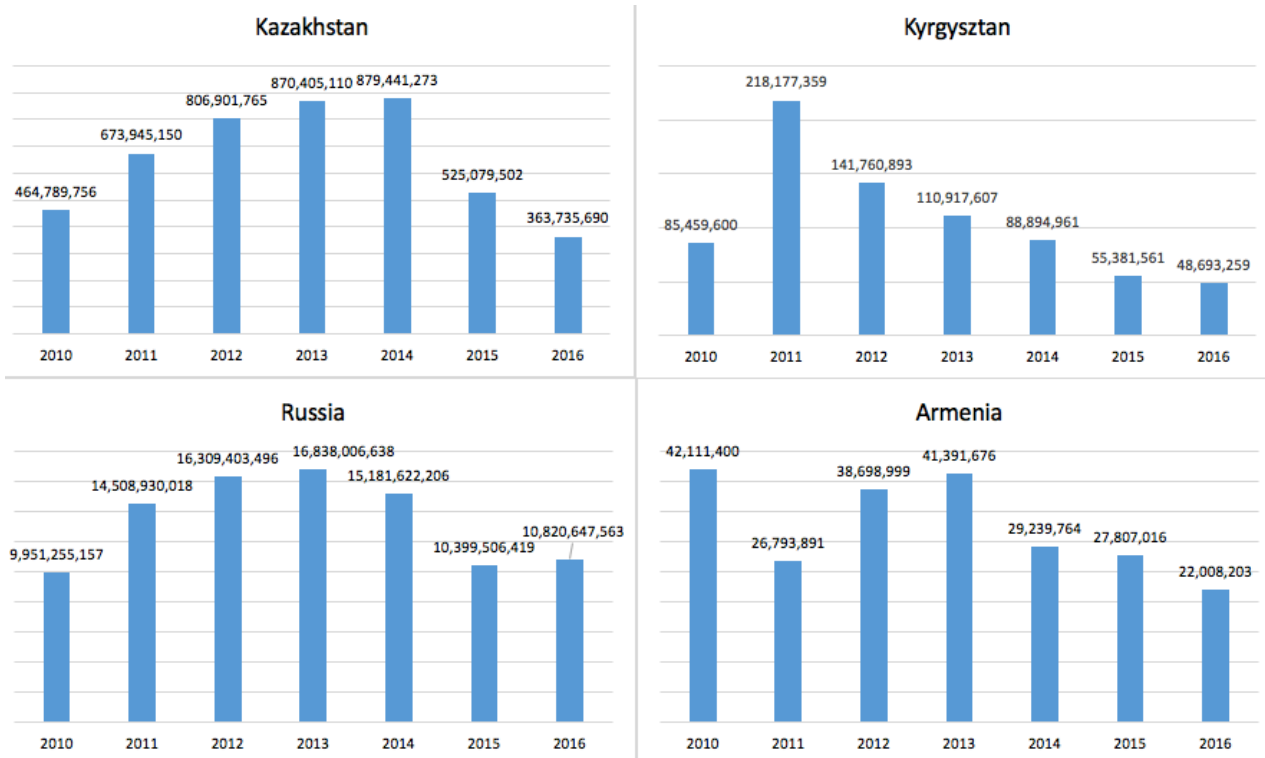


Figure 17 Exports to CU members Belarus
Source: Eurasian Economic Commission

Figure 18 shows the export to outside CU and the results are not positive. In 2011 there was a boom in export from Belarus to EU and the overall export increased by 107%. The growth continued until the end of 2012. Sudden decline in all exports to third countries happened. Export to EU and OPEC countries decrease by 40% and 5%. Export to other regions also decrease and had negative trend till the end of 2016.

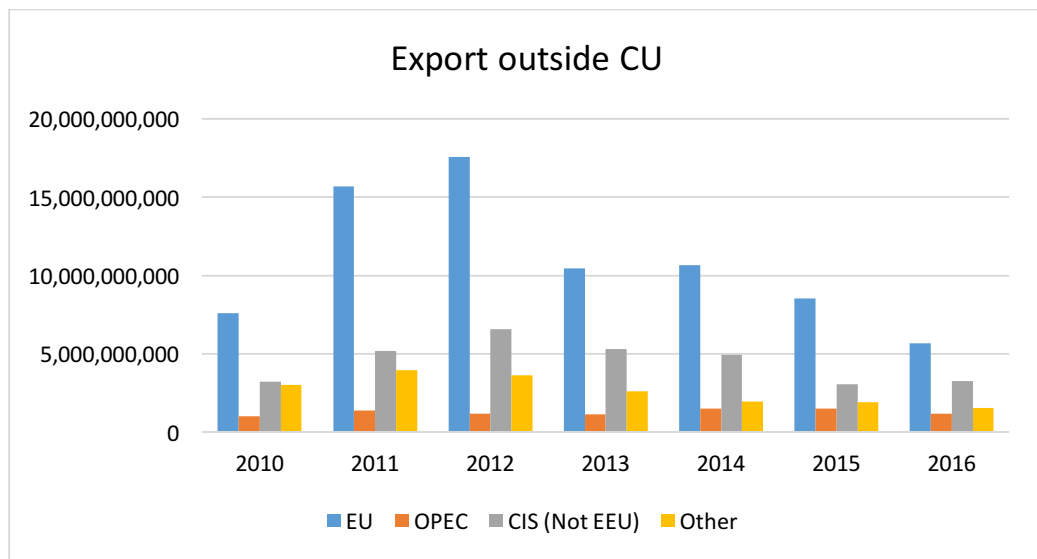
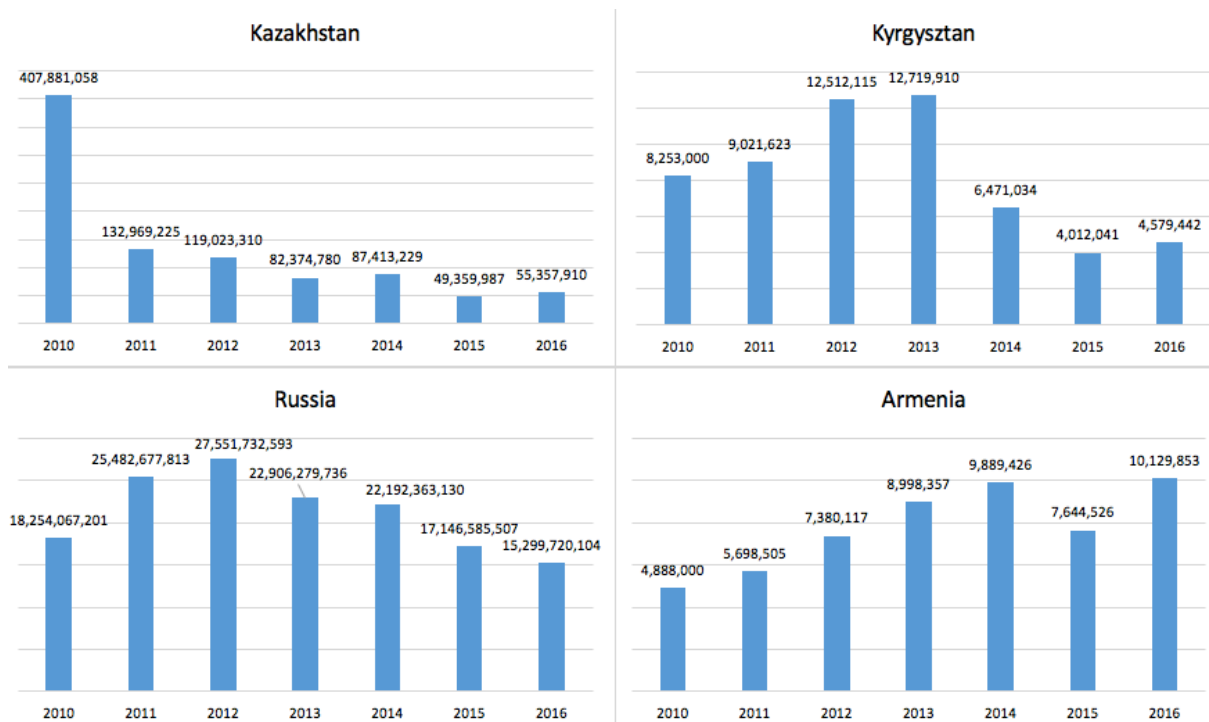


Figure 18 Exports outside CU Belarus
Source: Eurasian Economic Commission

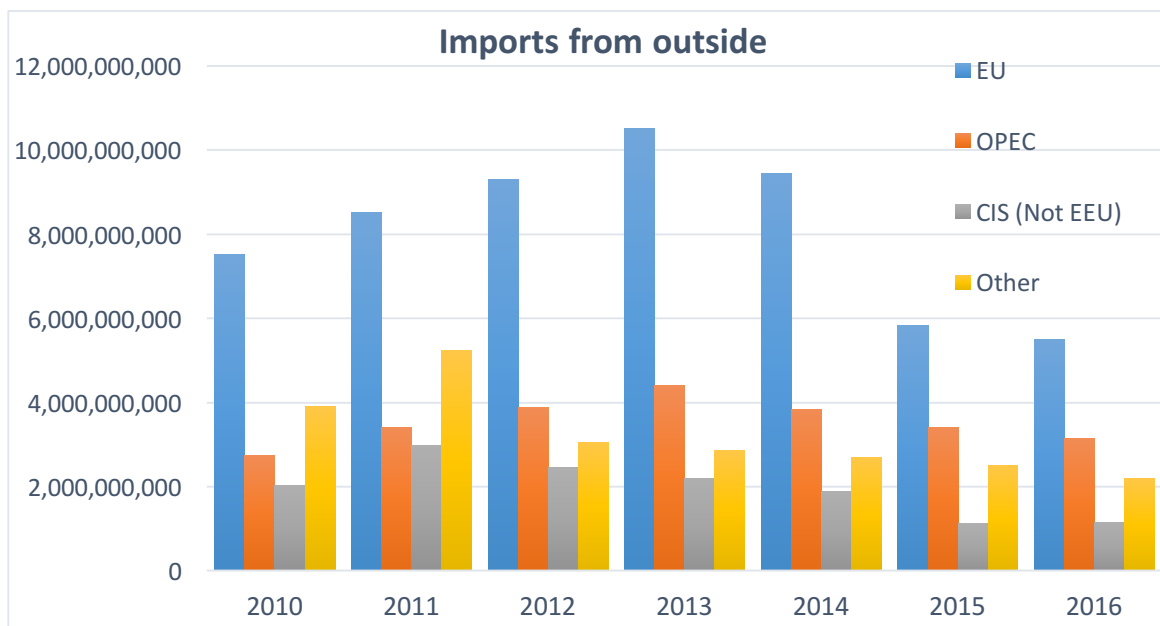


*Figure 19 Import from CU members Belarus
Source: Eurasian Economic Commission*

Figure 19 shows import from CU members in the periods 2010-2016. Let's start with effect of CU on import from Russia. In 2010 the import from Russia amounted to more than \$18 billion and it stated increasing after Belarus joined CU. The import from Russia increased in 2011 40% and in 2012 by 8%. The next years the trend was negative and the exports decreased in average by 13%.

The imports from Kazakhstan also had negative trend from the year of joining CU and it decline by average 13%. Import from Kyrgyzstan is not so big and it there is no evidence to state that joining CU effected the trade between these two countries. The overall conclusion from Figure 19 is that joining CU increased import from member Russia that is the main import destination of Belarus but it declined due to crisis.

Figure 20 shows the import from other countries. As the biggest import destinations from EU are Germany, Poland and Italy in 2011 amounted by \$4.7 billion that was 56% of all imports. Import from EU was growing in average by 12% till the end of 2013. The overall trend for all regions was the same as EU.



*Figure 20 Import from other countries Belarus
Source: Eurasian Economic Commission*

Table 12 show the chain index of export from Belarus to Russia compare to EU and OPEC countries. In the first case exports to Russia from Belarus compare to EU increased till 2013 and decreased till 2015, but the last year it increased by 57% compare to 2015. Chain index of exports from Belarus to Russia compare to OPEC was increasing till 2014. Next two years in was huge decline but 2016 showed 46% increase exports to Russia.

Base index in the case of Russia and EU showed positive trend and export in 2016 compared to 2010 increased by 46%. So it means that in \$1 exports to EU from Belarus, exports to Russia was \$1,46. Base index of exports from Belarus to Russia and OPEC showed that during 6 years' exports to Russia increased except 2015 but 2016 showed that it is recovering.

Table 13 show the chain index of export from Belarus to Russia compare to EU and OPEC countries. In the first case exports to Russia from Belarus compare to EU increased till 2013 and decreased till 2015, but the last year it increased by 57% compare to 2015. Chain index of exports from Belarus to Russia compare to OPEC was increasing till 2014. Next two years in was huge decline but 2016 showed 46% increase exports to Russia.

Base index in the case of Russia and EU showed positive trend and export in 2016 compared to 2010 increased by 46%. So it means that in \$1 exports to EU from Belarus, exports to Russia was \$1,46. Base index of exports from Belarus to Russia and OPEC showed that during six years exports to Russia increased except 2015 but 2016 showed that it is recovering.

Tables 13 Chain and Base indexes of Exports from Belarus to RU/EU and RU/OPEC

Years	2010	2011	2012	2013	2014	2015	2016
RU/EU	131%	92%	93%	161%	142%	122%	191%
Chain index	100%	71%	101%	173%	88%	85%	157%
Base Index (2010 = 100%)	100%	71%	71%	123%	109%	93%	146%
Years	2010	2011	2012	2013	2014	2015	2016
RU/OPEC	960%	1049%	1370%	1491%	1015%	679%	910%
Chain index	100%	109%	131%	109%	68%	67%	134%
Base Index (2010 = 100%)	100%	109%	143%	155%	106%	71%	95%

Chain index of imports to Belarus from Russia compare to EU showed the decline till 2013 but it increased in 2014 and 2015. In 2016 it was lower by 5%. The same index but Russia compare to OPEC showed negative trend. Despite the import from Russia was 6.6 time higher than imports from OPEC countries in 2010, its share continued decreasing till 2016.

Base index showed that except 2013 and 2014 imports from Russia was higher than from EU. In OPEC case the trend is negative for Russia. Compare to 2010 in 2016 imports from Russia compare to OPEC countries decreased by 27%.

Tables 14 Chain and Base indexes of Imports to Belarus from RU/EU and RU/OPEC

Years	2010	2011	2012	2013	2014	2015	2016
RU/EU	243%	299%	296%	218%	235%	294%	278%
Chain index	100%	123%	99%	74%	108%	125%	95%
Base Index (2010 = 100%)	100%	123%	122%	90%	97%	121%	114%
Years	2010	2011	2012	2013	2014	2015	2016
RU/OPEC	665%	749%	708%	518%	576%	504%	483%
Chain index	100%	113%	95%	73%	111%	87%	96%
Base Index (2010 = 100%)	100%	113%	107%	78%	87%	76%	73%

3.3.2. Investments

Foreign capital inflows increased sharply in the first half of the 2000s. However, they have been declining since 2008 due to the global economic crisis and the difficulties of the Russian economy on which Belarus remains strongly dependent. In 2016, FDI net inflows amounted to approximately USD 1 billion.

Belarus' main investors are Russia, the United Kingdom, Cyprus and Germany. The most attractive sectors for foreign investors are transportation, communications, computer technologies, real estate, agriculture, financial operations, construction and machinery. Belarus

ranks 37th (out of 190 economies) in the World Bank's 2017 Doing Business report, higher than in the previous year.

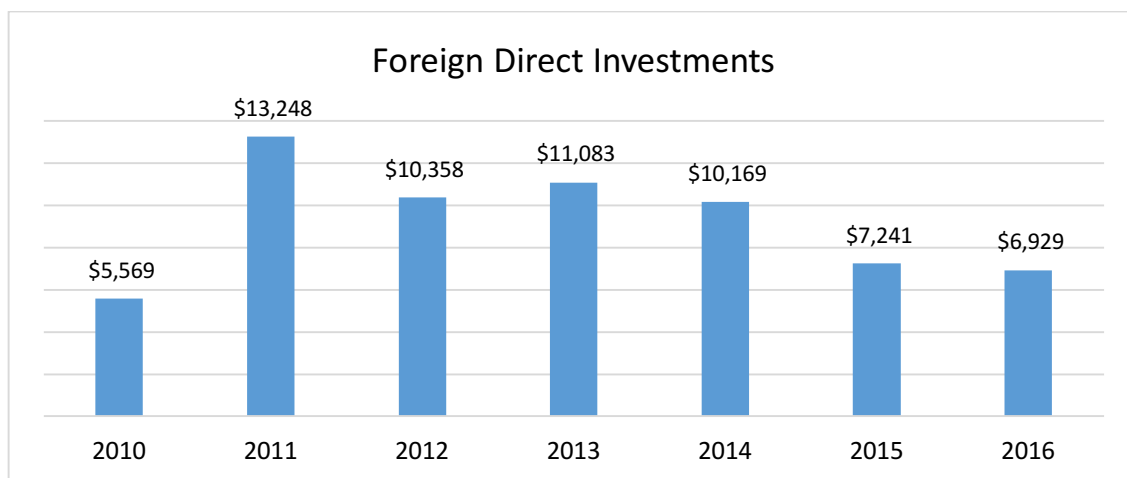


Figure 21 Foreign Direct Investments Belarus
Source: World Bank

According to Figure 21 maximum amount of investments was in 2011 with \$13.2 billion. The next year it declined by 22% and increased by 8% next year. The next 3 years FDI decreased by average 14%. The reason of decreasing FDI can be the economic crisis in Russia because it is the biggest investor to Belarus economy.

3.3.3. Migration

Migration outflow from Belarus mainly goes to Russia. However, effects of entering CU on migration can not be identified properly because between these two countries there is agreement of Union State of Russia and Belarus that enable free move of labor. Thus migration from Belarus did not effected after joining CU.

The agreement on the creation of the Union State of Russia and Belarus was signed on December 8, 1999 in Moscow and entered into force on January 26, 2000. Its signing was a continuation of the development of the integration processes laid down by the Treaty on Friendship, Good Neighborliness and Cooperation of February, the Treaty on the Formation of the Community of Russia and Belarus and the Treaty on the Union of Belarus and Russia of. The powers of the Union State include foreign policy, defense and security, budgetary, monetary and taxation systems, customs, energy, transport and communications systems.

3.4.Possible scenario for Tajikistan

The next step is to describe the possible scenario when Tajikistan enters CU. The analysis of 3 cases will be taken as the base. As in the cases in the chapter 3 possible scenarios will be depict in the areas of trade, investments and migration.

3.4.1 Trade

Tajikistan's main export partners are Turkey, Kazakhstan, Afghanistan, Switzerland and Russia. According to the Agency for Statistics of the country, in the export of goods, Turkey accounts for 22.3% of total exports Kazakhstan for 21.7%. Mainly non-ferrous metallurgy goods, in particular aluminum, as well as cotton fiber are exported to these countries. The list of the main exported goods includes: primary aluminum, cotton fiber and dried fruits.

Imports of goods to Tajikistan were carried out from Russia - 32.5% of total imports, China - 27.7%, and Kazakhstan - 15.9%. In 2016 the amount of exports of goods amounted to \$898.7 million and imports amounted to \$3.031 billion.

Tajikistan will go with scenario of Kazakhstan and Belarus in terms of imports. As it was mentioned Russia is a main importer both to Kazakhstan and Tajikistan. Analysis of the Kazakhstan case showed that imports from Russia was increasing by 13% annually. The same situation with import from Belarus. So it means that after joining CU the import from member countries will grow.

The suchlike effect can be seen in export within CU. In first 3 years of CU export to Russia the main export destination of Belarus exports, increased from Belarus. In overall the export to outside CU countries continue growing because CU does not limit the export potential of member countries.

In addition, all cases showed that import from outside CU continued growing even after the accession. So trade creation occurred because CU increased trade between members. However, trade diversion effects for now are not identified.

3.4.2. Investments

Tajikistan has benefited from USD 470.9 million in FDI inflow in 2015, a significant improvement when compared with the USD 377.4 million of FDI recorded in 2014. Aluminum, cotton and energy are the sectors that currently attract most foreign investment. Tourism is also revealing its potential. Tajikistan offers a favorable climate to regional and cross-border investment.

Between 2007 and 2015, the main investing countries are, in order, China, Russia, Kazakhstan, the United Kingdom, and the United States. Russia has notably invested in the construction of medium capacity hydroelectric central power plants and in the banking sector.

Accession to the Customs Union is accompanied by the signing of agreements on the unification of trade legislation and on additional investments. In addition, the creation of a single economic space, affecting the markets for goods, capital and labor within the CU, creates additional incentives for investment in the CU countries, not only from member countries, but

also from outside. The entry of Tajikistan into the Customs Union creates additional opportunities to attract foreign investment.

The most favorable strategy for joining the economic union is export-oriented. The investment potential of the republic is quite high taking into account the improvement of production efficiency. The presence of a large number of unused labor resources will promote greater efficiency in the use of new capital.

Joining the CES will simplify and make the rules of the game understandable for business, which will increase the flow of direct investment by residents of the SES. A number of measures are needed on the part of the government to facilitate the creation of the necessary market infrastructure (distribution, transport logistics, telecommunications, finance, roads, and warehouses).

The key investment sectors of the economy are: non-ferrous metallurgy (represented primarily by aluminum production), hydropower, agriculture, food industry, light industry (mainly textile). Investment resources are needed to develop infrastructure and human capital.

It should be noted that the increase in investment when joining the CU is not an axiom. There are examples of how the unfavorable investment climate has not allowed the use of the window of opportunities provided by economic integration within the framework of the economic union. At the same time, with the most-favored-nation treatment, the volume of investments - public and private, from the CU countries and from outside can reach significant values.

So the investment scenario will be like Belarus case as the major share of investments come to both countries from Russia. Russia continued investing in Belarus economy until the so called oil crisis and the joining Tajikistan to CU will give additional impulse in FDI inflow from Russia. As the highest share of FDI inflow is from China it will continue growing as entering CU will give some warranties that investment environment will be developed.

3.4.3. Migration

One of the main benefits of Tajikistan from joining the CU and SES is entering the single labor market. The SES agreements on labor migration (the agreement on the legal status of migrant workers and members of their families and the agreement on cooperation against illegal labor migration from third countries) are aimed at uniting the labor resources of the countries of agreements, the creation and effective functioning of the common labor market. The agreements define the legal status of migrants and their family members; regulate the labor relations of migrant workers, as well as the main issues related to the social insurance of migrant workers and members of their families. The result of the agreements is the weakening of the main barriers to the labor activity of migrant workers.

The migration scenario will be similar to Case of Kyrgyzstan because Tajikistan also depends on money transferred by migrant. As the migration outflow from Kyrgyzstan increased after joining CU the same situation will be with Tajik migrants. Removing barriers in the labor market will soon lead to an increase in the degree of legalization of employment, rather than an increase in the involvement of Tajik citizens in labor migration. For some migrants, the removal of formal requirements will mean an increase in the duration of migration episodes.

3.5. Customs Union effects on local companies

The analysis that was conducted in part 3 showed the effect of CU in the state level. We found that entering CU increase trade investments and migration within CU and further discussion will be about what does CU gives to local companies and how they should behave to obtain the maximum benefits from entering this union.

Joining CU will provide Tajikistan access to Single Economic Space (SES) that provides free movement for all the factors of production that are: goods, services, capital and labor. This in turn makes allocation of factors of production more efficiently and thus increase production.

Companies should realize that single market is a very competitive environment. Inefficient companies will lose their market share and some of them even will have to close down. In order to survive inefficient companies should raise their efficiency to decrease their costs.

However, joining CU single market will give companies several opportunities to expand their business. So by becoming member of CU the size of market increases and as the result demand goes up. To fulfill the higher demand, companies increase output, thus they achieve economic of scale. It means that they will be able to decrease the cost of production and decrease the price for final consumers. By taking advantages of economic of scale companies increase profitability.

Another benefit for companies is that monopolies will be faced with intensive foreign competition by companies from other members of CU. This will decrease the number of monopolies and decrease the price.

CU also aligns the economic environment and promotes fair competition by reducing the differences in production costs for producers with respect to taxes on imported raw materials and semi-finished products from third countries. That means companies in Tajikistan will pay the same price for imported material for their production as other members of CU and the final cost of production will be the same or even lower then in other countries.

In addition, joining CU opens for companies' large number of suppliers. Traders get broader source of goods hence bargaining power in dealing with suppliers resulting in cost reduction.

The main ideas of CU are removing border controls and trade barriers. By removing all barriers importing goods becomes faster because companies do not spend so much time for customs procedures in other countries. Therefore, the transaction costs will be lower and final consumer will pay lower price for products.

In addition, removing all border controls and trade barriers will decrease delivery time for local companies. One should not deny the significance of on-time delivery. Below are the main benefits of on-time deliver:

- Increase reputation
- Broaden relationships
- Encourage partners and customer's confidence
- Rise profit
- Improve efficiency

This could be a good starting point for companies from Tajikistan because in the very beginning after joining CU they have to have good reputation in order to work with foreign partners.

Above there were all benefits that local firms would benefit if Tajikistan enter CU. Next paragraphs will be about what should local companies do to survive in the larger market and to take benefits from it.

The first thing that some companies should do is specialization. It is a method of production where a company focuses only on the production of goods or services where it has comparative advantage. Comparative advantage theory was developed by David Ricardo and its main idea is that states, in our situation companies, should produce and export those goods production of which cost less compare to the same goods that were produced in other country with higher cost. So in order to survive and to use all benefits of CU and single market companies from Tajikistan should focus on that products that have comparative advantage.

CU will give a chance to companies to become internationalized. In order to successfully enter other markets companies should select the right entering mode strategies. Now most companies use exporting as the entry strategy but CU makes easier to enter with other strategies such as partnership or joint venture. As it was founded from the analysis of the cases joining CU in normal condition increases FDI, this would be a good opportunity to attract investments to expand the company and go international.

Internationalization also means designing and adapting the product in such way to allow easy localization for target markets, differing in culture, region or language. So if companies decided to export their products to other countries of CU they should think if the design and label of their products suits the exporting country.

Last but not least is the quality and safety of the products. Companies that do not fit the quality and safety standards will not be allowed to be imported to other countries. For example: the ban on import of dairy products from Belarus to Russia. Several times Rosselkhoznadzor did not allowed product from Belarus enter Russian market because there were dangerous substances detected inside them. Other reasons of ban on imports are not fully or incorrectly completed veterinary and accompanying documents. Unsatisfactory sanitary condition of vehicles is another reason of ban. So if companies want to export first of all they have to improve the quality of their products and fit all sanitary documents.

CONCLUSION

All types of economic integration have either negative or positive effects for member countries. As Tajikistan is the next real candidate for entering Eurasian Customs Union this paper was aimed to find social effect by means of migration and economic effects by means of trade and investments.

The objectives of this study were:

- To identify the effect of CU on Trade Balance.
- To investigate the difference on trade within CU and third countries
- To display the changes of import and export destination
- To find the influence of CU to FDI
- To identify the migration outflow after becoming member of CU

All stated research questions were answered by using multiple case study. As the sample it was decided to chose Kyrgyzstan, Kazakhstan and Belarus.

The first research question was the about effect of CU on trade and according to the finding trade within members increased after joining CU. However, export and import destinations of some members changed. In the case of Belarus, because of the Russian market exports to EU decreased.

The second research question was about effect of CU on FDI. In the first two three years after joining CU FDI inflow to member countries increased. The main investor was Russia but the crisis of 2014 when the price of oil declined to \$30-\$40 slowed down this process. In the long run FDI inflow will increase within CU.

The effect of CU on migration was identified in case of Kyrgyzstan. Joining CU increased Migration outflow from Kyrgyzstan to Russia and Kazakhstan.

If Tajikistan enters CU probably the trade will increase within CU and FDI inflow will increase. Migration outflow will increase and it will also lead to an increase in the degree of legalization of employment.

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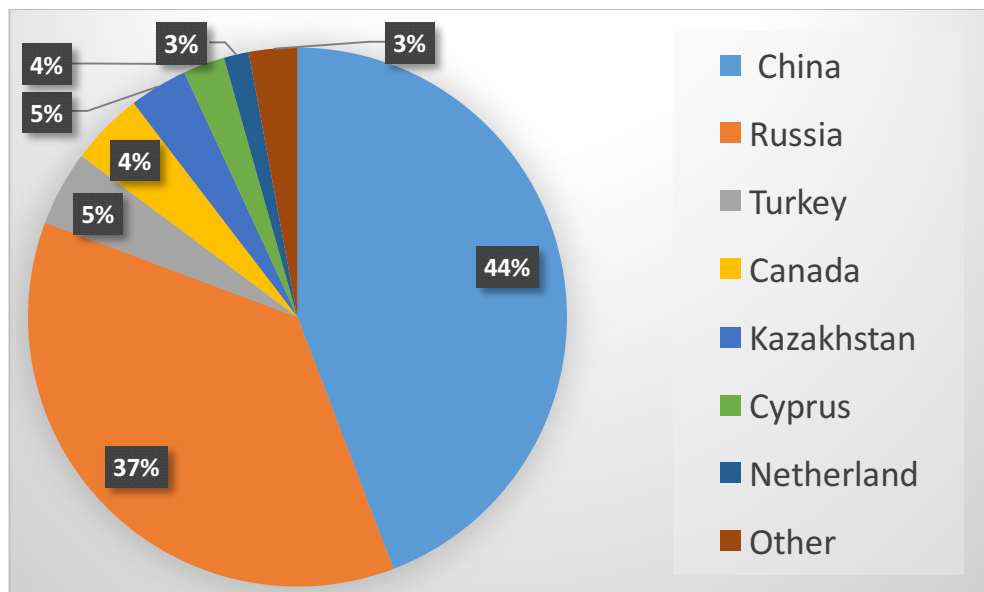
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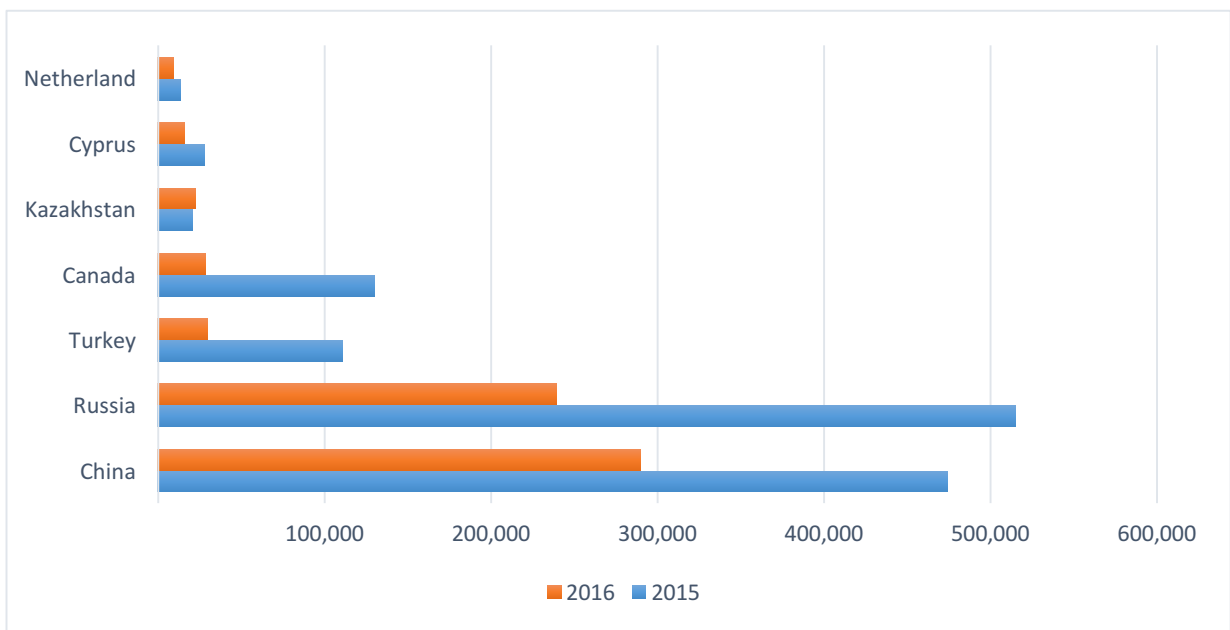
Appendix A. Top Investing Countries in 2016 Kyrgyzstan



Appendix 1. Top Investing Countries in 2016 Kyrgyzstan

Source: Trading Economics

Appendix B. Change in FDI after joining CU Kyrgyzstan



Appendix 2: Change in FDI after joining CU Kyrgyzstan

Source: Eurasian Economic Commission