

What should all the IBC members know about the Customs Union

Today joining of the Kyrgyz Republic (KR) to the Customs Union of Russia, Kazakhstan and Belarus is one of the most frequently discussed issues. The officials often argue in favor of joining to the alliance. However another part of specialists consider that entrance into the Customs Union will destructively affect living standards in the country and lead to economic downturn. All the citizens of the KR (whether they are company directors or salesmen, etc.) know this initiative will affect everybody. The main issue is “What will be if Kyrgyzstan decides to enter into the Customs Union?”. The purpose of the material is to give the most important information about the Customs Union and the consequences if the KR enters into the alliance.

According to the official definition, the Customs Union is an agreement of two or more states on abolition of customs duties in trade between them, the form of collective protection against third countries.

In compliance with the theory, the CU provides positive economic and social effects, such as price abatement owing to reduction of transport expenses, rise of competition at single expanded market, income effect of consumers owing to reduced prices and employment rehabilitation, income of producers because of increase of production and rise of demand for goods, increased manufacturability owing to rise of market volume.

The officials give statistical data during discussing arguments in favor of entering into the Customs Union.

According to the statistical data on trade, proportion of the states of the Customs Union in the total commodity circulation of the KR is 42.7%, in export is 33.6% and in import is 45.9%. The Russian Federation has the largest proportion in commodity turnover of the KR – 27.6%, Kazakhstan – 12.7% and Belarus – 2.4%.

Kyrgyzstan exports to Russia 48% of the total volume of clothes, 80% of cotton-fiber, 28% of electronic machines and instruments, 40% of incandescent lamps, to Kazakhstan – 88% of the export of electric energy, 96% of dairy products, 56% of vegetables and fruits, 58% of alive animals, to Belarus – 57% of the export of radiators, etc.

Kyrgyzstan imports from Russia 97% of the import of oil products, 34% of ferrous metals and articles made from them, 71% of timber, 17% of organic and inorganic chemical substances, from Kazakhstan – wheat and coal, 95% of wheat flour, 47% of inorganic chemical substances, 70% of mineral raw materials (flint sand, asbestos, gypsum), from Belarus – about 60% of the import of sugar, 14% of articles made of rubber, 12% of transport vehicles.

The export of Kyrgyzstan to the states of the Customs Union is more diversified in comparison with the export to other countries (in which gold prevails) and that's why contributes significantly to employment and acquisition of income by people.

Import from the countries of the CU is also significant. The country imports such strategically essential goods as oil and lubricants, grain, timber and rolled metal products. It is important for the country to be able to carry out duty-free import of the aforesaid articles. Import of these products is required while realizing large projects in hydropower industry, oil and gas industry, construction of residential and transport infrastructure.

Taking into account heavy proportion of the countries-members of the CU in external commodity turnover of the Kyrgyz Republic according to the official sources, it is important that

the states will not introduce export duties in mutual trade. Therefore if Kyrgyzstan doesn't enter into the CU, access to the CU market will be limited.

The other arguments of the Government in favor of the CU are:

- Creation of favorable terms for trade without customs frontiers. Frontier trade will have positive impact. People from border areas will be able to purchase and sell products on the cross-border region of the neighboring state without any limitations;
- The single market of railway transportation, single tariffication and technical regulation system;
- Membership of Kyrgyzstan in the CU will help to solve many problems with labour migration of citizens of the KR in the states of the CU because free migration policy will be provided.

The short-term consequences of entrance of Kyrgyzstan into the CU are as follows:

- ♦ Price advance for consumer products. The existing customs tariff will be increased on commodity items while harmonizing with the Single Customs Tariff of the CU. Prices for imported consumer products from China and other states are expected to be increased because the customs duty rate will be applied not on commodity weight but on its cost;
- ♦ Reduction of re-export and consequently decrease of employment and budget revenue. Increase in rates of customs duties and strengthening of customs control will impact the reduction of re-export from China that can reduce tax revenues from wholesale markets.

The medium-term and long-term consequences are as follows:

- ❖ Substantial growth of investment as the huge market without duties and barriers will be open for investors.
- ❖ It will be favorable for Chinese partners to produce goods in the KR and to deliver them to the CU market duty-free under the trademark "Made in Kyrgyzstan";
- ❖ Integration process in the CU can have an impact on restructuring of branches and sub-branches of industry in Kyrgyzstan. Some sectors will be able to develop quickly while others will not be able to meet competition. It will surely influence employment, income level and general economic development¹.

We should take into account point of view of the experts who are against entrance of Kyrgyzstan into the CU. The results of the survey held by the Fund of economic research "The project of the Future" in 2010 showed that entrance into the CU is actually joining the customs policy of Russia because 92% of the Single Customs Tariff is a tariff of the RF (the average customs tariff in Russia is 10.6%, and in the KR it is 5.1%). Experts explained that high customs duty is for protecting Russian products against cheaper and more qualitative import, and the Kyrgyz economy is different. It is based on re-export of Chinese goods, cash proceeds from migrants, gold mining, sale of electric energy, garment manufacture and export of agricultural and animal products, and the state doesn't have to protect somebody. It should provide its people with cheap and qualitative imported goods. The experts mentioned that as a result of limitations of import

¹ According to the materials of the Ministry of Economy of the Kyrgyz Republic.

from the countries which are not CU members people will have to buy Russian products which are less qualitative, energy-intensive and expensive in comparison with foreign counterparts. Experts underlined that Kyrgyzstan has free-trade zone with CU countries which stipulates zero customs duty for goods, and that's why the CU will not introduce cardinal changes to the economic cooperation with Kyrgyzstan, except for promotion of Russian goods to the market of the KR².

Also it should be relevant to pay attention to the opinion of one of Kazakhstan's economic experts Aidarkhan Kusainov³, because Kazakhstan is a member of the CU and have already felt the consequences of participation in it. According to the expert, "Customs Union provides a great opportunity for those who can actually produce goods with high quality." According to A. Kusainov CU is beneficial for exporters, and if this industry is organized thoroughly, joining the CU will be a great impetus for manufacturers. The expert cited the example of Kazakhstan's confectionery factory "Rahat", which is "absolutely happy in the Customs Union", as the company exports its products with preferential terms to Moscow and Altai.

Expert shared his experience of business development: "When we went to the Russian market, there were many organizational problems: cargo shipping, customs clearance, obtaining Russian certificates that are issued only in Russia. Our Russian partners recommended to open an office in Russia. They don't want to go through complicated procedures - to accept the goods at the border and pay a fee. With the entrance in the Customs Union all the procedures have become much easier. All certificates we received in Kazakhstan, a van with the goods was sent to the border, the cargo were delivered, and our work was finished there. Business became noticeably simplified."

Regarding the displacement of domestic products from the Kyrgyz market by Russian goods, expert pointed out that the struggle for the consumer always exists, as it is a business. However, in terms of domestic market local producer is in a more stable position than his rival newcomer because it has already developed distribution channel, it is known in the market and the cost of logistics is excluded.

Citing the example of Kazakhstan, the expert noted that entering the CU will give an additional impetus to Kyrgyz farmers and livestock farms. He noted that, according to the customs statistics, exports of Kazakh goods under "fruits and vegetables" is noticeably increased by 2.5 times. And although (as pointed out by expert) vegetables are cheaper than oil and don't give such a large growth, but it is a new market for the producers and new opportunities for export.

Expert expressed the view in respect of negotiations: "From the point of view of negotiations, it is possible to ask a few billion dollars compensation, plus investment program for five years. We must honestly say that 20% of the population feeds by the markets "Dordoi", "Madina" and "Kara-Suu", and that Kyrgyzstan will agree to enter CU only in case of ensuring 20% of the population for at least two years until they adapt and switch to production"⁴.

By summarizing all of the above, it is important to note that the possibility of joining the CU may entail both positive and negative consequences. The benefits of integration will not be

² URL: <http://ictsd.org/i/news/bridgesrussian/76721/#sthash.w7FvAuWE.dpuf>

³ Aidarkhan Kusainov, master of economics, former Director of the Department of gas industry of the Ministry of Energy of Kazakhstan, Director General of the consulting company "Almagest".

URL: <http://www.stanradar.com/news/full/6270-ajdarhan-kusainov-tamozhennyj-sojuz-stabiliziruet-kyrgyzstan.html>

⁴ URL: <http://www.stanradar.com/news/full/6270-ajdarhan-kusainov-tamozhennyj-sojuz-stabiliziruet-kyrgyzstan.html>

generated automatically, and the government needs to consider how to make changes in economic policies to achieve a positive effect and reduce the negative consequences. Measures should be taken to support the priority sectors of the economy and export development in a competitive market in the CU.

The government hopes that the partners will take into account the current situation of the Kyrgyz Republic and will agree to make concessions with regard to preferences and transition period.

The only thing is to hope that the Kyrgyz authorities will take effective solution through negotiations with the States of the CU.

Kyrgyz authorities have developed a "roadmap" for entrance in the Customs Union. The studies on the implications of joining the CU were carried out during the negotiations process. In this regard, certain positions were announced which the Kyrgyz Republic proposed to take into account.

Thus, Kyrgyzstan in the process of joining to the CU (as an example of funds established in the European Union for the new member states) made the paragraph about creating a fund to support entrepreneurs of Kyrgyzstan. Kyrgyzstan also expects a one-time financial assistance from the CU for equipping the customs and border crossing points on the border with China, Uzbekistan and Tajikistan. In addition, funds are needed to clean up compliance mechanisms of sanitary and phytosanitary standards.

Meeting of the Supreme Eurasian Economic Council (EEC), which took place in late 2013, approved a "roadmap" for entrance in the KR to the Customs Union except preferences. However, the Kyrgyz government said it would not accept a "road map" without taking into account national interests. The members of the Customs Union did not set strict time frame for Kyrgyzstan.

Currently, services are forming the main part of the GDP of Kyrgyzstan, while the Customs Union is aimed at production. Kyrgyzstan needs to restructure the economy to meet the requirements of the CU, so the government has chosen a gradual integration of the countries of the Customs Union, said Oleg Pankratov, Adviser of the Prime Minister's Office.

The first stage of accession to the base of treaties of the CU includes free movement of goods and hereafter Kyrgyzstan will join the agreement on the movement of capital, services and labor. KR announced early accession to migration block. Moreover, position on major markets is well-defined, hundreds of thousands of Kyrgyz citizens are employed, and closing these markets can cause social tensions in the country.

Discussion of the "roadmap" for entrance of Kyrgyzstan in the CU will continue at a meeting of the Supreme Council of the ECE in March. According to the First Deputy Prime Minister Djoomart Otorbaev, after settling all the thorny issues Kyrgyzstan will be ready to sign an application for membership in the alliance.

In February 8 in Sochi Presidents of Kyrgyzstan and Russia agreed that in the next few days under the leadership of the First Deputy Prime Ministers convergence of positions on the participation of Kyrgyzstan in the Eurasian integration processes will be initiated. The two governments step by step will develop measures to adapt the structure of the Kyrgyz economy in order to avoid any risks in the country's entrance in the Customs Union and the Common Economic Space.

The article was prepared by

**Nurbek Maksutov,
Deputy Executive Director of the International Business Council**

**Sultan Khalilov
Lawyer of the International Business Council**