



UNIVERSITY  
OF CENTRAL ASIA

GRADUATE SCHOOL OF DEVELOPMENT

Institute of Public Policy and Administration

# **Economic Cooperation Between Russia and Central Asian Countries: Trends and Outlook**

Irina Sinitsina



WORKING PAPER №5, 2012





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## **Abstract**

This paper analyses key issues in economic interaction between Russia and countries of Central Asia (including Afghanistan): trade between Russia and countries of the region, commodity composition and dynamics of trade turnover for the last decade; regimes of trade between these countries; Russian investments to the countries of the region; economic significance of labour migration from the countries of the region to Russia; the role of Russia in development of human potential in the countries of the region; Russian development aid to the countries of the region; economic policy and strategy of Russia regarding the relationships with the countries of the region; and some considerations on the impact of relations with Central Asia on economic development of Russia.

## **Keywords**

Russia, Central Asia, international trade, trade regimes, foreign investments, international migration, external economic policy

JEL Codes: F10, F14, F15, F22, F24, F35

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## Acronyms

CA	Central Asia
CAREC	Central Asia Regional Economic Cooperation Program
CC	Customs Code
CES	Common Economic Space
CIS	Commonwealth of Independent States
CSTO	Collective Security Treaty Organization
CTSC	Council on Technical Standardization in the Construction Field
CU	Customs Union
CUC	Customs Union Commission.
EADB	Eurasian Development Bank
EAEU	Eurasian Economic Union
EU	European Union
EurAsEC	EuroAsian Economic Community
FDI	Foreign direct investment
FEA	Foreign economic activities
FEACC	Foreign Economic Activity Commodity Classification
FMS	RF Federal Migration Service
FTZ	Free Trade Zone
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GPP	Gas-processing plant
HEI	Higher education institution
HPS	Hydroelectric power station
ICDO	International Civil Defense Organization
ICS	Intergovernmental Council on Standardization, Metrology And Certification
IMF	International Monetary Fund
JSC	Joint Stock Company
JV	Joint venture
LLP	Limited Liability Partnership (in Kazakhstan)
MFN	Most Favored Nation
NFC	Nuclear fuel cycle
PSA	Production Sharing Agreement
RAID	Russian Agency for International Development
RF	Russian Federation
SCO	The Shanghai Cooperation Organization
SME	Small and medium enterprises
UAC	United Aircraft Corporation
UNCTAD	United Nations Conference on Trade and Development
UNDP	UN Development Programme
UNICEF	The United Nations Children's Fund
USA	United States of America
USAID	US Agency of International Development
USD	US dollar
WFP	UN World Food Programme
WTO	World Trade Organization

## 1. Introduction

The Central Asian (CA) region encompasses six diverse countries; five of which – Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan and Turkmenistan – have 70 years of common Soviet history with Russia, and Afghanistan, that underwent a long-term period of civil war. This land-locked region largely remains a dead end for the transit of goods from Russia to adjacent countries, due to lack of access to sea ports, and still under-developed road, railway and pipeline infrastructure connecting the region with countries outside the former USSR.

Following the disintegration of the Soviet Union, Russia's economic links with CA countries were abruptly cut off, and have not yet fully recovered. Five members of the former USSR entered the Commonwealth of Independent States (CIS), but Turkmenistan suspended its membership, and retains observer status. In 2008, Afghanistan indicated an intention to join CIS and currently has observer status in the CIS Inter-parliamentary Assembly. In 2010, Kazakhstan joined the Customs Union (CU) with Russia and Belarus: the three CU member states form a Common Economic Space (CES) based on the World Trade Organization (WTO) principles and open for accession of other states. Since 2012, Kazakhstan also participates in the work of the Eurasian Economic Commission, a supranational governing body for the CU and CES. Four CA countries are currently members of Collective Security Treaty Organization (CSTO); Uzbekistan suspended its membership in June 2012 and Turkmenistan announced its neutrality in 1995. Kazakhstan, Kyrgyzstan and Tajikistan are members of the EuroAsian Economic Community (EurAsEC), while Uzbekistan also suspended its membership in this organisation (see Table A.1 in Annex).

The countries of Central Asia are inhabited by over 96 million people (2010) and demonstrate diverse levels of economic development levels, which determine the basic framework of Russia's cooperation with each of the countries. According to World Bank classification, Russia has an upper middle-income economy. In Central Asia, Russia cooperates with low-income economies (Afghanistan, Tajikistan and Kyrgyzstan) that are host to almost 49 % of the region's population (of which Afghanistan has 36 %), with lower middle income countries (Turkmenistan and Uzbekistan) which make up about 35 % of total population, and with Kazakhstan, which has 17 % of population, and also has an upper middle-income economy. General characteristics of economic potential and development of CA countries are presented in Table A.2.

The region includes both countries with abundant hydrocarbon deposits (Kazakhstan, Turkmenistan and Uzbekistan) and those experiencing an acute shortage of energy resources (Tajikistan, Kyrgyzstan and Afghanistan). The CA region, particularly Kazakhstan, possesses significant reserves of coal, iron and nonferrous metal, especially copper and polymetallic ores, mercury, antimony, gold and uranium. Tajikistan and Kyrgyzstan also have large hydropower potential. The abundance of resources makes CA countries attractive partners for extra-regional actors such as the European Union (EU), China, the USA, and to some extent Turkey, which have significantly increased their economic and political impact in the region in the past two decades.

Russia still effectively remains the pivot of post-Soviet economic relations in Central Asia. However, it has largely forfeited the role of leading actor, and has yet to fully exploit opportunities for economic integration in the region. Complicated processes of nation-building in the countries that emerged after the breakup of the Soviet Union, also contributed to the decline of Russia's position in the region, narrowing the environment for expanding economic, cultural and humanitarian links between Russia and CA countries, and for economic re-integration.

## 2. Trade between Russia and CA countries

### 2.1. Trends in trade between Russia and CA countries

Until its disintegration, the Soviet Union remained the major driving force of CA countries' development, making a decisive impact on the evolution of the region's current realities. The breakup of the Soviet Union in 1991 resulted in the weakening of economic ties between the Russian Federation (RF) and CA countries. In 1992, the turnover of goods between RF and CA<sup>1</sup> decreased by tenfold compared to 1991, and remained at a relatively low level (USD 6-9 billion annually) until 1998.<sup>2</sup> Following the financial and economic crisis in Russia, the goods turnover in 1999 declined to just 45.6 % of the 1996 level, with Russian exports to CA countries dropping more (42.4 %) than imports (65.8 % of the 1996 level). From 2000, trade relations stagnated, with intensification beginning only in 2003.

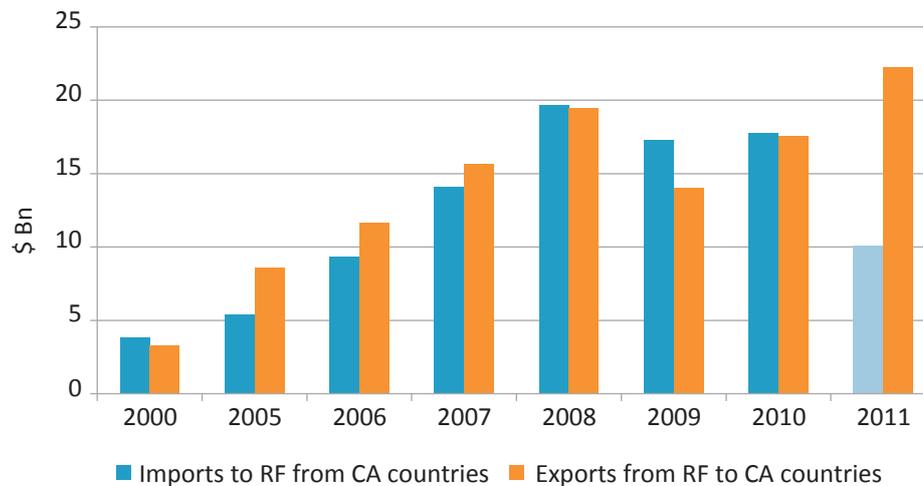
During 2003-2008, RF/CA goods turnover grew 5.2 times, reaching almost USD 40 billion. Of these, exports from Russia increased 4.5 times, while imports to RF grew 6.2 times, mostly due to natural gas purchases.<sup>3</sup> Trade expansion was promoted by a political rapprochement between Kazakhstan, Uzbekistan, Kyrgyzstan and Tajikistan, on the one hand, and RF, on the other. In 2008-2009, mutual trade turnover decreased noticeably (by about 20 %) due to the global economic and financial crisis. Exports from RF fell by 28 %, while imports from CA countries decreased by about 12 %. During the post-crisis period, trade turnover grew, exceeding, according to preliminary estimates, the 2008 level by 2011. See Figure 1 for trends in trade between RF and CA countries from 2000 to 2011.

<sup>1</sup> Hereinafter, Afghanistan is included in the CA region.

<sup>2</sup> Vladimir Paramonov and Aleksey Stokov, "Central Asia: Existing and Potential Oil and Gas Trade," *ARAG Paper 08/03E, Central Asia Series* (Shrivenham: Defence Academy of the United Kingdom, 2008).

<sup>3</sup> Hereinafter, unless noted otherwise, cumulative data on goods turnover between RF and CA countries for 2005 – 2010 are estimated to include the cost of natural gas purchases made by JSC Gazprom in Kazakhstan, Uzbekistan and Turkmenistan, which is not reflected in official statistics. These estimates were based primarily on foreign trade statistics published by RF and several CA countries. In the absence of the latter, UNCTADstat data were used which in most cases represent UNCTAD staff estimates.

Figure 1. Trends in trade between RF and CA countries, 2000-2011 (current prices)



Sources: CA countries' national statistics, Rosstat and UNCTADStat data. Estimates of natural gas purchases cost are based on JSC Gazprom data (<http://www.gazprom.ru/about/production/central-asia/>), mass media reports and industry analytics. 2011 imports data do not include purchases of natural gas in CA countries, due to lack of data.

## 2.2. The role of Russia as a trading partner for CA countries

Russia plays an important role in the foreign trade of CA countries to varying degrees, depending on the country (see Table 1). These differences concern both volumes of bilateral trade and relative significance of trade with Russia for specific countries. If natural gas deliveries are included, Uzbekistan depends on trade with Russia to the greatest extent; Russia accounted for over 50 % in commodity exports, and for almost 25 % in imports in 2010, and over the past 15 years, this dependence has increased. Kazakhstan also depends significantly on its trade with Russia, which makes up over 13 % of its total exports and 43 % of imports. However, while the proportion of Kazakh imports from Russia has been growing, the fraction of its exports to RF decreased almost twice compared to 2000. The importance of Russian imports in Kyrgyzstan is also consistently high (over 30 %), but Russia's role as an export market for Kyrgyz goods has declined. Similar trends are observed in Russian-Tajik trade. Russia's share in Turkmen exports, particularly natural gas, declined from 40 % in 2006 to 28 % in 2010.

Table 1. Significance of Russia as a trading partner for CA countries (%)

RF share in exports	1995	2000	2005	2006	2007	2008	2009	2010	2011
Afghanistan	7.5 <sup>a</sup>	3.7 <sup>a</sup>	1.7 <sup>a</sup>	3.9 <sup>a</sup>	2.4 <sup>a</sup>	2.8 <sup>b</sup>	3.8 <sup>b</sup>	5.7 <sup>b</sup>	8.9 <sup>b</sup>
Kazakhstan									
According to official data	45.1 <sup>c</sup>	19.9 <sup>c</sup>	10.5 <sup>c</sup>	9.8 <sup>c</sup>	9.8 <sup>c</sup>	8.7 <sup>c</sup>	8.2 <sup>c</sup>	9.6 <sup>c</sup>	8.7 <sup>c</sup>
Estimate*	...	...	11.2	10.6	11.5	10.8	13.7	13.4	...
Kyrgyzstan	22.8 <sup>a</sup>	16.5 <sup>a</sup>	22.2 <sup>a</sup>	17.3 <sup>c</sup>	17.8 <sup>c</sup>	16.7 <sup>c</sup>	11.1 <sup>c</sup>	14.7 <sup>c</sup>	14.8 <sup>b</sup>
Tajikistan	12.7 <sup>a</sup>	33.0 <sup>a</sup>	9.1 <sup>a</sup>	4.6 <sup>a</sup>	6.6 <sup>a</sup>	8.8 <sup>a</sup>	10.2 <sup>a</sup>	8.5 <sup>a</sup>	7.2 <sup>b</sup>
Turkmenistan									
According to official data	6.4 <sup>a</sup>	34.1 <sup>a</sup>	1.5 <sup>a</sup>	1.4 <sup>a</sup>	1.0 <sup>a</sup>	1.1 <sup>a</sup>	1.0 <sup>a</sup>	2.2 <sup>a</sup>	0.9 <sup>b</sup>
Estimate*	...	...	9.3	29.6	37.6	38.0	33.0	23.5	...

RF share in exports	1995	2000	2005	2006	2007	2008	2009	2010	2011
Uzbekistan									
According to official data	...	32.0 <sup>a</sup>	27.9 <sup>a</sup>	27.7 <sup>a</sup>	25.6 <sup>a</sup>	20.2 <sup>a</sup>	18.9 <sup>a</sup>	27.1 <sup>a</sup>	12.4 <sup>b</sup>
Estimate*	...	...	31.8	34.2	33.5	36.0	43.3	42.1	...
RF share in imports									
Afghanistan	5.0 <sup>a</sup>	1.9 <sup>a</sup>	3.5 <sup>a</sup>	2.6 <sup>a</sup>	3.1 <sup>a</sup>	5.7 <sup>b</sup>	10.1 <sup>b</sup>	10.7 <sup>b</sup>	15.9 <sup>b</sup>
Kazakhstan	49.9 <sup>c</sup>	48.4 <sup>c</sup>	38.0 <sup>c</sup>	38.3 <sup>c</sup>	35.5 <sup>c</sup>	36.3 <sup>c</sup>	31.3 <sup>c</sup>	39.4 <sup>c</sup>	42.7 <sup>c</sup>
Kyrgyzstan	21.9 <sup>a</sup>	23.9 <sup>a</sup>	34.2 <sup>a</sup>	33.8 <sup>c</sup>	34.9 <sup>c</sup>	36.6 <sup>c</sup>	35.9 <sup>c</sup>	33.6 <sup>c</sup>	27.2 <sup>b</sup>
Tajikistan	17.3 <sup>c</sup>	15.6 <sup>c</sup>	19.2 <sup>c</sup>	24.6 <sup>c</sup>	32.0 <sup>c</sup>	32.0 <sup>c</sup>	30.9 <sup>c</sup>	32.3 <sup>c</sup>	22.6 <sup>b</sup>
Turkmenistan	9.6 <sup>a</sup>	13.5 <sup>a</sup>	10.0 <sup>a</sup>	10.6 <sup>a</sup>	10.3 <sup>a</sup>	15.9 <sup>a</sup>	11.6 <sup>a</sup>	9.3 <sup>a</sup>	10.2 <sup>b</sup>
Uzbekistan	...	14.1 <sup>a</sup>	26.3 <sup>a</sup>	26.4 <sup>a</sup>	26.8 <sup>a</sup>	22.4 <sup>a</sup>	20.5 <sup>a</sup>	24.5 <sup>a</sup>	20.0 <sup>b</sup>

\* Including natural gas purchases

a Estimates by UNCTADStat

b Calculated based on Rosstat data

c Calculated based on CA countries' national statistics

Sources: CA countries' national statistics, Rosstat and UNCTADStat data. Estimates of natural gas purchases based on JSC Gazprom data (<http://www.gazprom.ru/about/production/central-asia/>), mass media reports and industry analytics.

In Central Asia, Kazakhstan has the largest volume of commodity trade with Russia, due to the production, transport and processing of hydrocarbons, and the electric power industry. Uzbekistan is next, due to its growing natural gas exports and the reduction of Russian gas purchases from Turkmenistan (which accounts for over 90 % of Turkmen exports to Russia). Trade with Kyrgyzstan and Tajikistan does not yet play a significant role in trade between CA countries and Russia. The relative importance of the region's countries in their exports to and imports from Russia is presented in Table 2.

**Table 2. Relative importance of CA countries in Russian trade with the region, 1995 – 2010 (%)**

	1995		2000		2005		2010	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Afghanistan	0.5	0.2	0.3	0.1	1.2	0.1	3.1	0.1
Kazakhstan	61.1	69.3	74.3	45.4	76.8	57.5	69.8	47.1
Kyrgyzstan	4.1	3.0	3.1	2.2	4.4	2.7	6.2	1.4
Tajikistan	3.9	3.4	3.2	6.7	3.0	1.5	4.9	0.6
Turkmenistan	2.9	3.2	7.4	22.2	3.4	8.8	4.4	15.4
Uzbekistan	27.5	20.9	11.6	23.4	11.2	29.3	11.7	35.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

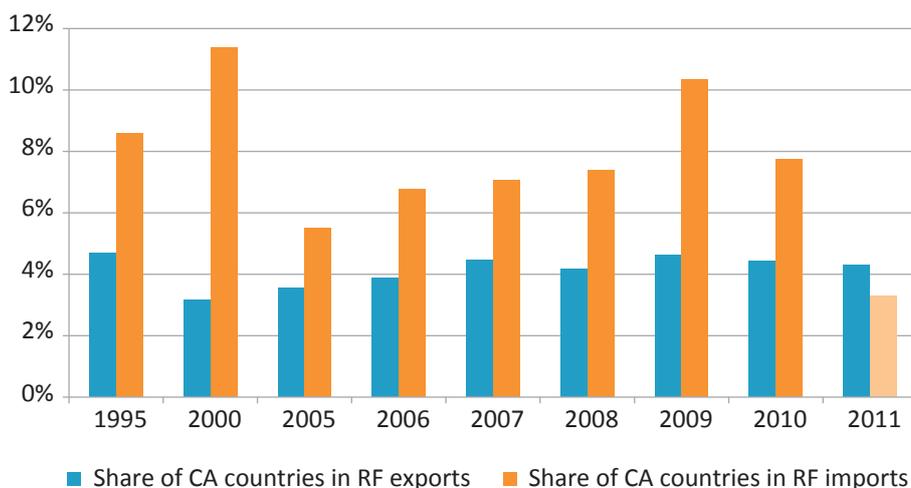
Sources: CA national statistics, Rosstat and UNCTADStat data. Estimates of natural gas purchases based on JSC Gazprom data (<http://www.gazprom.ru/about/production/central-asia/>).

Despite a reduction in commodity turnover between Russia and several CA countries, Russia still remains an important trading partner for all of them due to its leading role as a sales market for goods produced by CA extracting and manufacturing industries, as well as their agricultural sectors, which are significant employers. This implies a sustainable interest in retaining and continuing cooperation with Russia on the part of CA businesses and entrepreneurs.

### 2.3. The role of CA countries in Russian foreign trade

The share of CA countries in the aggregate volume of Russian foreign trade gradually declined from 6.2 % in 1995 to 4.1 % in 2005. It then started to grow, and reached its peak of 6.7 % in the crisis year of 2009, due mostly to growing purchases of natural gas by Gazprom at rising prices. During this period, the proportion of total Russian imports noticeably exceeded those of aggregate RF exports. From the mid-2000s, however, the gap between these two figures was somewhat reduced (see Figure 2).

**Figure 2. The importance of CA countries for Russian foreign trade, 1995 – 2010 (%)**



*Sources: CA national statistics, Rosstat and UNCTADStat data. Estimates of natural gas purchases cost are based on JSC Gazprom data (<http://www.gazprom.ru/about/production/central-asia/>), mass media reports and industry analytics. 2011 imports data do not include purchases of natural gas in CA countries, due to lack of data.*

The decline in the proportion of RF-CA trade in the mid-2000s was partly due to the growth in Russian demand for manufactured products, equipment, technologies and consumer goods, being met by increasing proportion of imports from the “far abroad” (i.e. from beyond CIS). Intensification of trade between CA countries and “far abroad”, similar to other CIS countries, led to a relative slowdown of intra-regional trade, hindering integration processes and strengthening centrifugal tendencies in the region. The low competitiveness of the majority of goods manufactured in CA countries, coupled with growing world prices for basic supplies and raw materials, promoted the consolidation of their international specialization in primary, low-technology products. These processes led to a convergence of economic and export structures in some CA countries, which also strongly reduced incentives to integration.

During the world financial crisis, the contraction of trade with “far abroad” resulted in some growth of relative importance of mutual trade between RF and CA countries. However, in 2009, economic relations between Russia and CA countries became strained, particularly the Russian-Turkmen gas conflict set back efforts (see Section 4).

A characteristic feature of Russian exports to CA countries closely relates to the higher degree of diversification of its commodity structure, compared to exports to non-CIS countries. Kazakhstan is among three countries (following Ukraine and Belarus in 2008) with the highest RF

export diversification index. Exports from Russia to Kazakhstan include 188 items<sup>4</sup> with values exceeding USD 10 million. For machines and equipment, this export diversification index is even higher and is increasing.<sup>5</sup> This fact is essential for assessing the significance of CA countries for Russia, since it characterizes these countries as major consumers of a wide specter of Russian manufactured goods which are non-competitive in the markets of “far abroad”.

Consequently, in mid-2000s, Russia once again became the major trade partner of Kazakhstan in its imports (goods turnover grew to USD 10 billion), but descended from second to third position in Kazakh exports, giving the way to EU and China. Currently, RF is the major trading partner for Uzbekistan and Tajikistan, as well as the second most important trading partner for Kyrgyzstan following China. Due to a reduction in Turkmen natural gas purchases by Gazprom, Russia moved from first place among trading partners of Turkmenistan to second, giving way to Iran.<sup>6</sup>

#### 2.4. Commodity structure of Russian trade with CA countries

The structure of mutual trade between Russia and CA countries is characterized by a dominance of energy products and raw materials. The proportion of energy resources (including natural gas purchases by Gazprom) in RF-CA trade turnover increased from 25.4 % and USD 3.6 billion in 2005 to 33 % and USD 11.7 billion in 2010. Still, the volume of trade in the energy sector in physical terms remains low compared to the Soviet era. These energy flows have a bilateral character: exports of energy products (coal, crude oil, petrochemicals and electric power) from Russia to CA countries in 2007-2010 ranged from USD 2.9 to 5.5 billion, which is comparable to import volumes of energy resources from these countries.<sup>7</sup> Russia consumes only a small share of CA fossil fuels, transporting a major proportion to Ukraine and western Europe. Russian interests in the region are primarily related to control over energy resources.<sup>8</sup> Russian presence in the CA energy market has been gradually growing since the 1990s: initially concentrated in Kazakhstan, Gazprom began to penetrate Uzbek and Turkmen markets in the early 2000s, and from 2005, the markets of Kyrgyzstan and Tajikistan.<sup>9</sup>

In the commodity structure of Russian exports to CA countries, the share of manufactured products is larger than that of imports from CA countries, but it does not change the overall pattern of primary commodity orientation of trade between these countries. In 2010, fossil fuels accounted for almost 31 % of Russian commodity exports to CA countries, while the overall proportion of primary commodities, including agricultural raw materials, ores and metals,

<sup>4</sup> According to 4-digit codes of Foreign Economic Activity Commodity Classification (FEACC).

<sup>5</sup> S.A. Kulik, A.N. Spartak, I. Yurgens, *Ekonomicheskie interesy i zadachi Rossii v SNG* (Moscow: Ekon-Inform, 2010).

<sup>6</sup> RF Ministry of Economic Development, “Turkmenistan” (press release), 2011, <http://www.economy.gov.ru/wps/wcm/connect/add0848047c397299e7fff0b17164af7/turkmenistan.doc?MOD=AJPERES&CACHEID=add0848047c397299e7fff0b17164af7>.

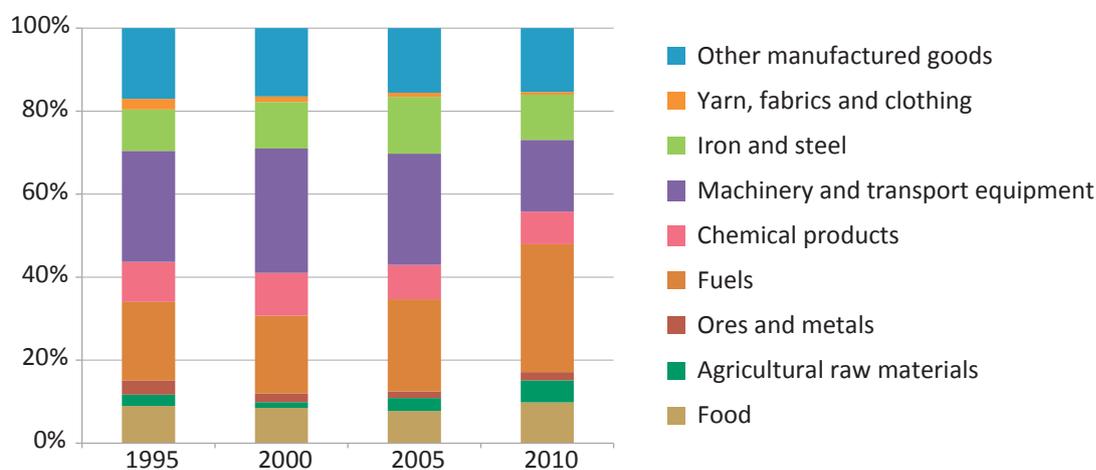
<sup>7</sup> According to (incomplete) UNCTAD data.

<sup>8</sup> Marlène Laruelle, “Russia in Central Asia: Old History, New Challenges?”, *Working Report Europe - Central Asia Monitoring (EUCAM)* No. 3 (September 2009), [http://www.eucentralasia.eu/fileadmin/user\\_upload/PDF/Working\\_Papers/WP3-EN.pdf](http://www.eucentralasia.eu/fileadmin/user_upload/PDF/Working_Papers/WP3-EN.pdf).

<sup>9</sup> Paramonov and Stokov, *Central Asia...*

amounted to almost 40 %. It is characteristic that the proportion of this commodity group in the total volume of Russian exports to CA countries has recently enlarged (see Figure 3).

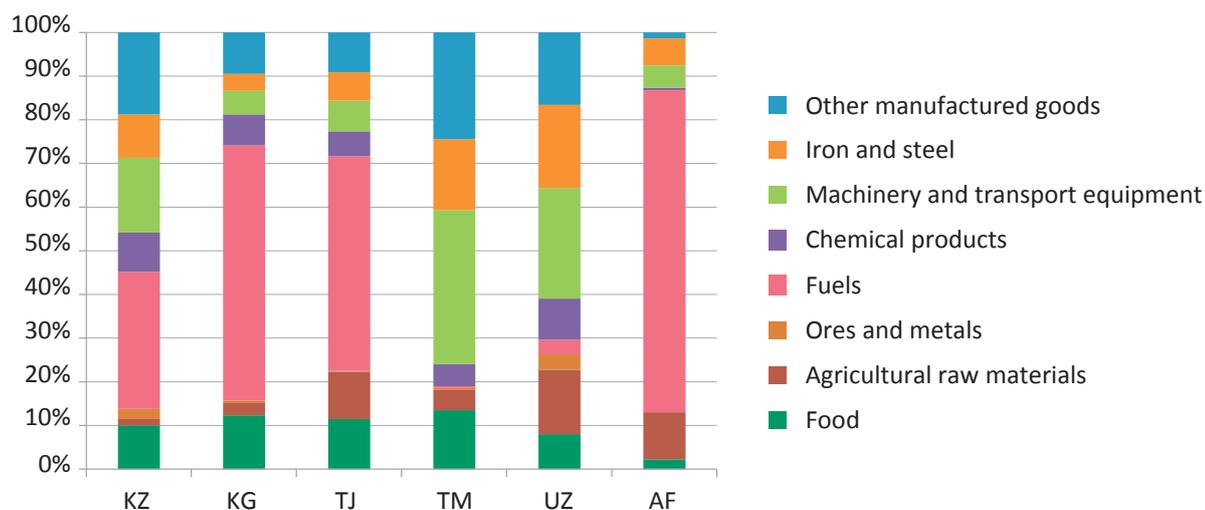
**Figure 3. Commodity structure of exports from Russia to CA countries, 1995-2010 (%)**



Source: UNCTADStat

In some cases, Russia supplies primary resources to the region in exchange for imports of natural gas; gas deliveries to Russia are partially paid for in cash, and partially in kind with Russian goods, including primary commodities. With the exception of Uzbekistan and Turkmenistan, CA countries are dependent on Russia for fuel and raw material supplies (see Figure 4). Turkmenistan's gas industry, a major source of foreign currency earnings, depends on gas transportation via Russian territory, as well as on Russian equipment and components for gas production and transport.<sup>10</sup> Uzbekistan supplies Russia with cotton fibres, natural gas, tungsten and molybdenum concentrates and, in exchange, receives Russian aluminum and raw materials for the iron and steel industries.

**Figure 4. Commodity structure of exports from Russia to individual CA countries, 2010 (%)**

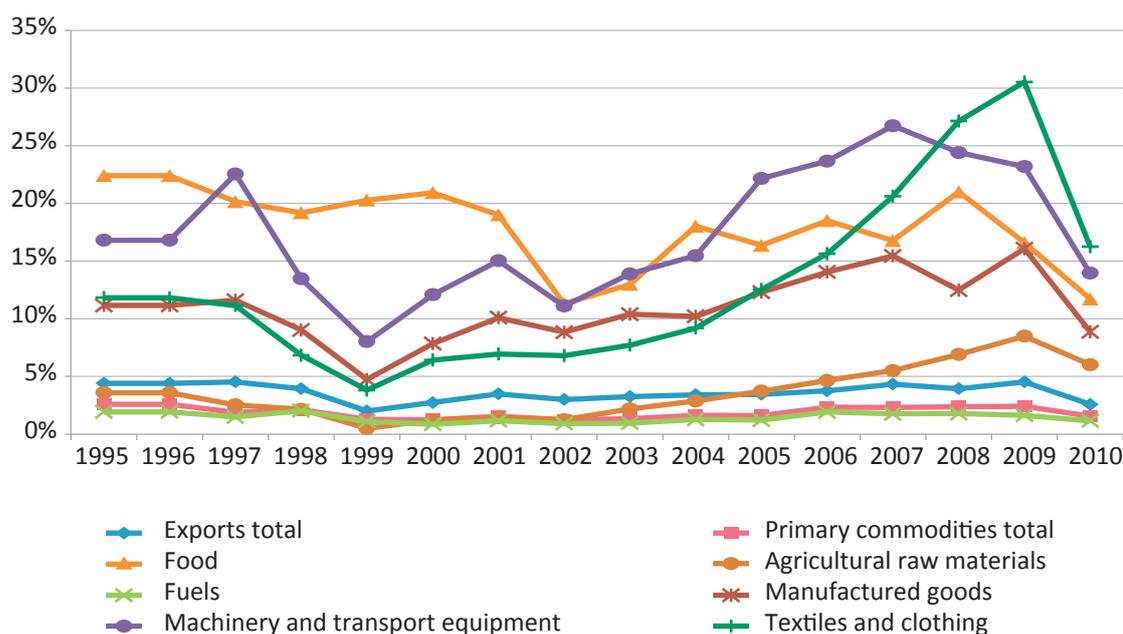


Source: UNCTADStat

<sup>10</sup> Vladimir Paramonov and Aleksey Stokov, *Torgovo-ekonomicheskie otnosheniia mezhdou Rossiei` i stranami Central'noi` Azii: istoriia i sovremennost`*, September 21, 2010. <http://ceasia.ru/ekonomika/torgovo-ekonomicheskie-otnosheniya-mezhdou-rossiey-i-stranami-tsentralnoy-azii-istoriya-i-sovremennost.html>.

CA markets are important for Russian exports of manufactured goods, such as foodstuffs, machinery and transport equipment, and, more recently, textiles. Throughout the 2000s, CA countries received 10 – 17 % of their total exports from Russia, including up to 27 % of exported machinery and transport equipment (see Figure 5). By the end of decade, however, the share of industrial goods in Russian exports to Central Asia started to decline gradually (from 66 % in 2005 to 52 % in 2010), giving way to primary commodities. The proportion of machinery and transport equipment was reduced almost by half, from 30 % in the early 2000s to 17 % in 2010 (see Figure 3).

**Figure 5. Share of CA countries in exports of individual commodity groups from Russia (%)**



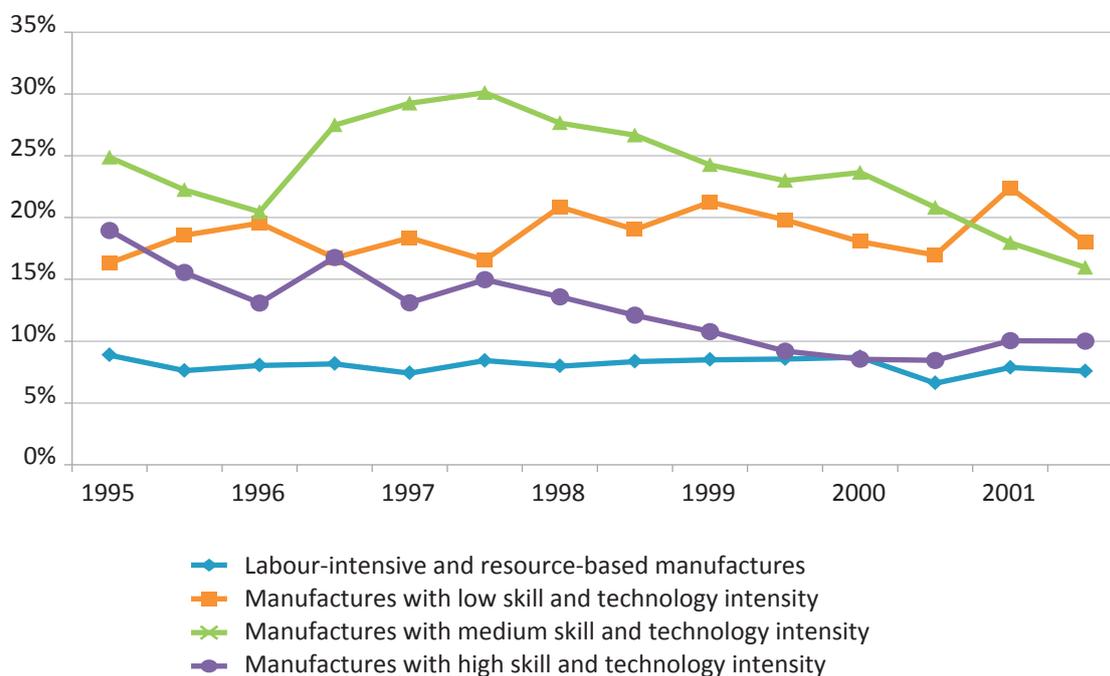
Total Russian exports of commodities in a given group = 100

Source: UNCTADStat

For Russia, the reduction in the proportion of manufactured exports with a high degree of processing in cumulative exports to CA countries (and other CIS countries as well) was especially sensitive. The percentage of high-technology goods in total exports to CA countries almost halved from 19 % in 1997 to 10 % in 2010, while that of medium-technology intensity goods decreased from 30 % in 2002 to 16 % in 2010. At the same time, the share of goods with low technology intensity increased from 16.6 % in 2002 to 22.4 % in 2009 (see Figure 6). Experts associate the decreased demand for Russian manufactured goods by CA countries with growing competition from the countries of the “far abroad” which offer high technology goods of superior quality (and frequently at lower prices), that are more adequate to the requirements of CA developing economies.<sup>11</sup>

<sup>11</sup> Kulik et al., *Ekonomicheskie interesy...*

**Figure 6. Structure of Russian exports of manufactured goods to CA countries by degree of manufacturing (% of total exports)**



Source: UNCTADStat

This situation was partially affected by institutional limitations for Russian exports, primarily the insufficient development of foreign economic activities' (FEA) incentives, such as export support mechanisms. Government export guarantee schemes operating in Russia to a certain extent discriminate against CIS countries, including CA economies, classifying them as the highest risk group with minimal limits of guaranteeing, thus reducing incentives for the involvement of Russian companies. To provide government guarantees for the development of Russian exports of manufactured goods, all partner countries are subdivided into four categories according to degree of risk: from minimal (0) to maximum risk (3). Of these, categories 1 to 3 include countries without the credit rating of an investment class and for which guaranteeing limits are established. Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan have been assigned to category 3, the highest risk group with annual limits of funding from 10 to 50 million USD.<sup>12</sup> These allocations of limits are not consistent with Russian foreign economic priorities and are likely a reflection of the current status of mutual settlements between the countries. Other export support programmes, such as partial compensation of export credit rates from the federal budget and subsidy assistance to small and medium enterprises (SMEs) producing and selling exportable goods, are also poorly focused on promoting regional cooperation.

CA countries' significance in Russian imports grew in the second half of the 2000s (see Figure 2) as primarily a result of a three to four-fold escalation in fossil fuel prices, especially

<sup>12</sup> RF Government, "Perechen' inostrannykh gosudarstv, eksportu promyshlennoy produktsii v kotorye v 2008–2010 godakh okazyvaetsia gosudarstvennaia garantiynaiia podderzhka s uchetom predel'nykh ezhegodnykh ob'emov garantirovaniia", Instruction No 566-p, April 25, 2008, <http://base.garant.ru/12160087/>.

those of natural gas imported from CA countries, even taken a shrinkage of its purchases in physical terms by Gazprom by the end of the decade (Table 3).

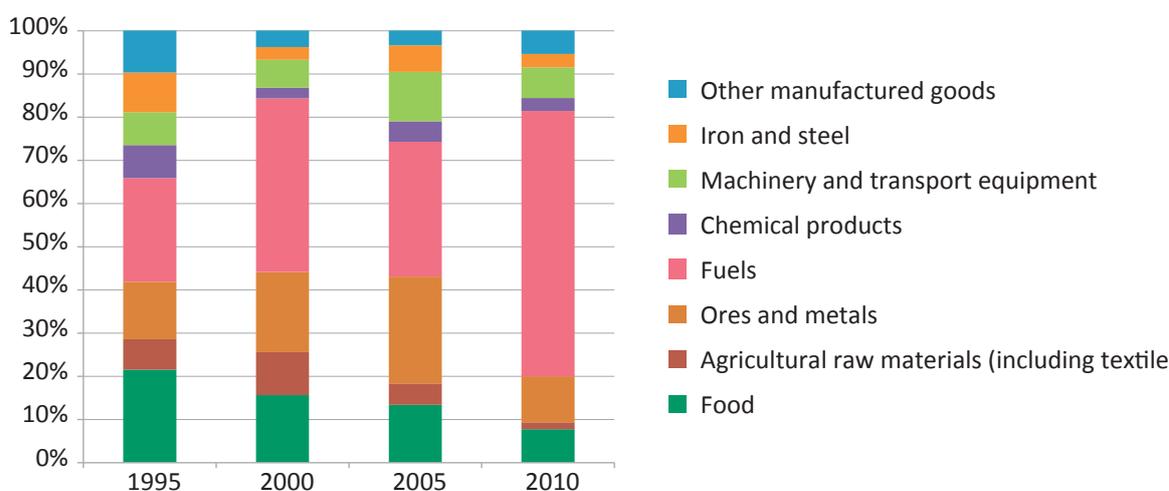
**Table 3. Purchases of Central Asian natural gas by Gazprom Group, 2000–2010**

Year	Kazakhstan		Uzbekistan		Turkmenistan	
	Purchases, billion cub. m	Price, USD/1000 cub. m (estimate)	Purchases, billion cub. m	Price, USD/1000 cub. m (estimate)	Purchases, billion cub. m	Price, USD/1000 cub. m (estimate)
2000	1	30	...	...	20	30
2005	6.2	50	6	45	3.8	60
2006	7.2	65	9.3	60	41	65
2007	8.5	130	9.6	100	42.6	110
2008	9.6	190	14.2	180	42.3	140
2009	10.1	290	15.4	300	11.8	260
2010	12.4	230	13.9	220	10.7	190

Sources: JSC Gazprom (<http://www.gazprom.ru/about/production/central-asia/>), media reports, industry analytical materials.

In the 2000s, the proportion of agricultural and raw material imports by Russia from CA countries declined, with corresponding growth in the significance of fossil fuels. The proportion of energy products in the commodity structure of RF imports from CA countries grew from 40 % in 2000 to 61 % in 2010, while the percentage of agricultural raw materials' imports dropped six-fold, and those of foodstuffs and ores and metals declined two-fold. This period also saw a relative increase in shares of chemical and textile imports, imports of iron and steel and machinery and transport equipment (see Figure 7), resulting in a noticeable growth of imports both in kind and in value.

**Figure 7. Commodity structure of Russian imports from CA countries, 1995 – 2010 (%)**

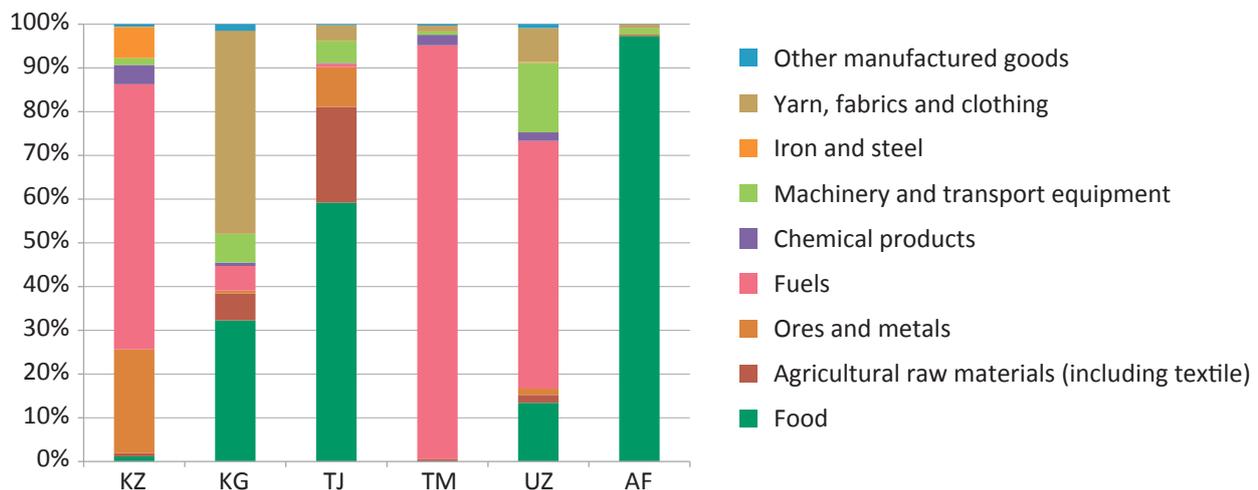


Source: UNCTADStat, adjusted for natural gas purchases by Gazprom Group

Based on importance for the Russian economy, imports from Central Asia can be categorized as follows (see Figures 7 and 8):

- Energy products, first of all natural gas, intended primarily for re-export to Ukraine and European countries;
- Raw materials and intermediate products scarce in Russia (manganese ore, chromites, alumina, cotton, silk, wool, melons, etc.) or more competitive than Russian products in some regions of Russia (e.g. coal and iron ore from Kazakhstan for use in Russian Urals steelworks);
- Finished goods supplementing and moderately competing against domestic products (e.g. zinc, lead, aluminum and rolled steel); and
- Finished goods occupying a significant share of the Russian market, ousting in some cases domestic goods – for example, Uz-Daewoo passenger cars (sales in Russia – 93,000 in 2011), inexpensive clothes, wheat, fruit, vegetables, nuts, dried and salted fish.

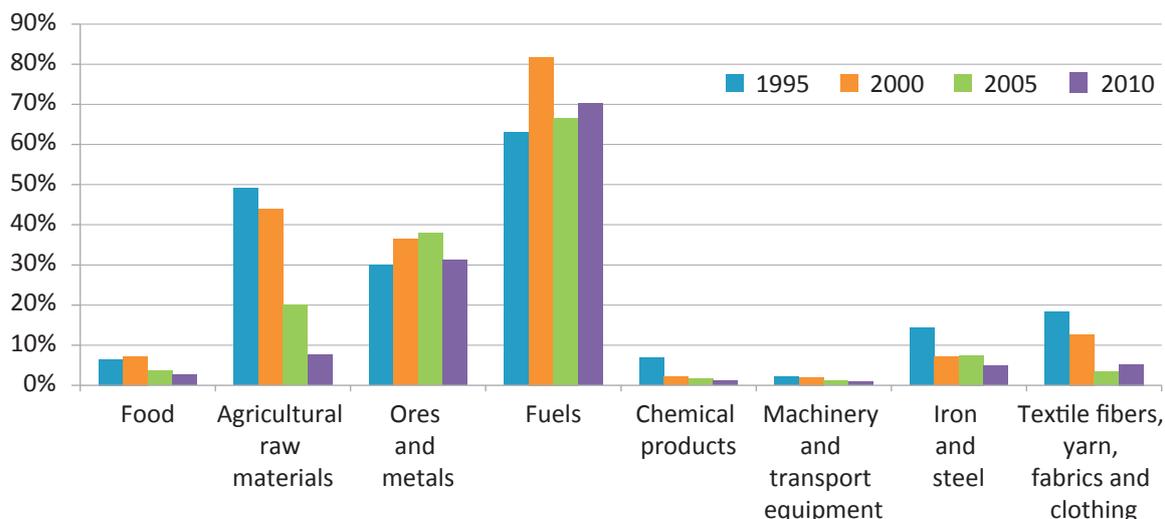
**Figure 8. Commodity structure of Russian imports from individual CA countries, 2010 (%)**



Source: UNCTADStat, adjusted for natural gas purchases by Gazprom Group

Apart from imports of natural gas from Turkmenistan and Uzbekistan, Russia takes the opportunity to import cheap fuel (mainly coal) from Kazakhstan, releasing more resources for their own exports. The CA countries are important suppliers of cotton, the basic raw product for Russian garments industry, and play a significant (equivalent to the countries of the “far abroad”) role in supplying Russia with scarce fruits and vegetables, but the bulk of their imports is unstructured. The role of CA countries as suppliers of passenger cars, textile and apparel products competitive in the Russian market is growing as well (see Figure 9).<sup>13</sup>

<sup>13</sup> Kulik et al., *Ekonomicheskie interesy...*

**Figure 9. Share of CA countries in Russian imports of individual commodity groups (%)**

*Total Russian imports of commodities in a given group = 100*  
*Source: UNCTADStat, adjusted for natural gas purchases by Gazprom Group.*

The proportion of machinery, equipment and other technical goods in the structure of Russian imports from CA countries is low (Figure 9), but the markets of Russia and other CIS economies still play an important role in the development of technological industries in Central Asia. According to national statistical data, CIS countries accounted for 73.8 % of Kazakhstan’s total exports of machinery and transport equipment in 2011, while the share of other countries was just 26.2 %. In Kyrgyzstan, Russia accounted for 32.8 % of exports of the same commodity groups in 2010. Russia fulfills its demand for high-quality investment and consumer goods that CA countries are not in a position to offer with imports from “far abroad”.

## 2.5. Russian trade with Customs Union partner Kazakhstan

Kazakhstan is one of Russia’s top ten trading partners. According to Kazakh national statistics, the share of Russia in Kazakhstan exports recently declined to 8 – 9 %<sup>14</sup>, while in imports it has increased from 31.3 % in 2009 to almost 43 % in 2011 (Table 4). Mutual trade volume, after some decline in 2009-2010, amounted to almost 24 billion USD, exceeding the pre-crisis maximum of 2008 by 19 %. Still, the balance of mutual trade for Kazakhstan remained negative in 2011, exceeding 8.5 billion USD.

<sup>14</sup> National statistics probably do not include purchases of Kazakh natural gas made by Gazprom Group. Authors of the current paper estimate the Russian share in Kazakhstan exports, including natural gas, at approximately 14 %, while its negative balance in trade with Russia stands at about 4 billion USD.

**Table 4. Kazakhstan trade with Russia, 2008-2011 (current prices)**

	2008		2009		2010		2011	
	USD m.	% of total						
Exports to RF	6228.1	8.8	3547.0	8.2	5714.9	9.5	7668.1	8.7
Imports from RF	13765.6	36.3	8896.5	31.3	12258.9	39.4	16185.4	42.7
Goods turnover	19993.7	18.3	12443.5	17.4	17973.8	19.7	23853.5	18.9

Source: Republic of Kazakhstan Statistical Agency, 2012.

An analysis of the commodity structure of trade between Russia and Kazakhstan indicates the predominance of fuels and raw materials. According to Customs Union data, the commodity structure of Kazakhstan exports to RF in 2011 was dominated by metallic ores (30.9 % of total exports to Russia), mineral fuels (26.9 %), and iron and steel and their products (12 %). The major items of Kazakhstan imports from Russia were mineral fuels (26.9 %), machinery and equipment (15 %), and iron and steel and their products (12.3 %).<sup>15</sup>

The significant role of energy products in mutual trade is related to the structural and technological interdependence of energy sectors of national economies inherited from the Soviet Union. For example, refineries in Kazakhstan were not designed to process oil containing sulfur and cannot process most crude oil extracted in the country, except from Tengiz oilfield. Kazakhstan therefore supplies a large proportion of its oil to Russian refineries, and Russian oil flows to Kazakhstan for processing at Kazakh refineries. Similarly, Russia and Kazakhstan exchange considerable amounts of coal. Coal from the Kuznetsk basin in Russia is supplied to border regions of northeastern Kazakhstan, while coal from Ekibastuz field in Kazakhstan is delivered to nearby Russian oblasts. Northern Kazakhstan regions and boundary Russian oblasts also exchange electric power, as these regions are part of an integrated power grid. These examples demonstrate that the intensity of trade between Russia and Kazakhstan is to a large extent associated with the inertia of traditional economic links within the former Soviet Union. Experts believe, however, that the structure of this trade is also indicative of a high degree of exhaustion of the potential for mutual trade development.<sup>16</sup>

Russian experts point out that preserving a high proportion of energy products in the structure of both Russian and Kazakhstan exports does not promote integration processes between the economies – members of CES, but rather limits efforts to energy integration that has a direct export orientation.<sup>17</sup> Integration processes could be intensified by expanding mutual deliveries within the framework of intra-sectoral production cooperation, accompanied by a modernization of participating economies. Without these efforts, the significance of integration efforts such as the CU and CES in promoting regional trade will decline.

<sup>15</sup> Customs Union. "Ob itogakh vneshney i vzaimnoy trgovli gosudarstv - chlenov Tamozhennogo soiuz v 2011 godu", 2011, [http://www.tsouz.ru/db/stat/Analitika/Documents/Analytics\\_2011.pdf](http://www.tsouz.ru/db/stat/Analitika/Documents/Analytics_2011.pdf).

<sup>16</sup> Kulik et al., *Ekonomicheskie interesy...*

<sup>17</sup> A. Suzdaltsev, "Ocenka i prognoz razvitiya integratsionnykh protsessov na postsovetskom prostranstve" (paper presented at the 13th April International Academic Conference on the Problems of Economic and Social Development, Moscow, April 3-5, 2012), <http://regconf.hse.ru/uploads/4b0dcde26b9c083eb08f46edaec1dc187e32ef6e.doc>.

### 3. Trade regimes and technical regulations

#### 3.1. Free Trade Zone: Formation history and substantive provisions

Since the early 1990s, efforts towards the liberalization of trade and movement of production factors in the post-Soviet space, and the development of common norms and rules for commercial and economic cooperation and economic activities within CIS have been underway. However, until recently, cooperation was based on bilateral trade agreements signed at the end of the 1990s. In 1994, Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Uzbekistan and Ukraine signed the Agreement on a free trade zone (FTZ), providing for a cancellation of tariff and non-tariff restrictions in mutual trade and the elimination of numerous trading barriers. In 1999, the same countries signed protocol on amendments and additions to the FTZ Agreement, a framework document which was adapted to the needs of each member state. This protocol introduced a multilateral free trade regime for CIS, cancelled all customs duties and quantitative restrictions on goods traded between FTZ Agreement members and established a dispute resolution procedure.

However, not all signing states (including Russia) ratified the FTZ agreement and protocol. At that time CIS states have not yet shaped a full-scale multilateral trade regime: in fact, they failed to produce an agreed or list of exemptions from this regime that should have become an integral part of the protocol, which hampered the realization of the regional free trade zone. The result has been that previous bilateral agreements dominated trade regimes between countries.

Until recently, the regime of free trade within CIS was based on about 110 bilateral and multilateral preferential trade agreements that contained exemptions from the free trade regime. However, while it reduced the number of tariff and non-tariff restrictions on imports, the regime still did not protect from various discrimination effects. The next stage was a transition to a more clear and stable multilateral regime. On October 18, 2011, eight CIS states (Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan and Ukraine), which accounted for over 90 % of mutual trade within CIS, signed a new FTZ Agreement.<sup>18</sup> In June 2012, the FTZ Agreement was signed by Uzbekistan. Azerbaijan and Turkmenistan continue negotiations to join the Agreement.<sup>19</sup>

The FTZ Agreement is entirely based on principles and arrangements reached within the General Agreement on Tariffs and Trade (GATT) and WTO. The Agreement documents all existing exemptions from the free trade regime and contains provisions regarding waiving customs duties and not increasing duty rates for exempted goods. The number of exemptions for imports was substantially reduced, covering only three commodity groups (alcohol, sugar and tobacco), and exemptions will not come into practice until January 1, 2015.

<sup>18</sup> As of July 15, 2012, FTZ Agreement was ratified by only two states – Russia (April 2012) and Belarus (May 2012). The Agreement will enter into force within 30 days of notification of the third ratification.

<sup>19</sup> “RF spustia 18 let ratifitsiruet Dogovor o zone svobodnoy trgovli v SNG,” March 28, 2012, <http://top.rbc.ru/economics/28/03/2012/643742.shtml>.

The Agreement also sets cancellation dates for existing import exemptions and provides a dispute resolution procedure based on international practice.<sup>20</sup> Provisions regulating freedom of transit shipments, as well as obligations of parties to develop a specific agreement on pipeline transit are set forth in detail, with a reference to a GATT article.

The FTZ Agreement documents obligations of the parties to be guided by rules and principles of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures. The Agreement contains a provision on developing protocol defining parties' obligations on rules and procedures regulating public procurement. Article 9 deals with the application of antidumping and compensatory measures in mutual trade and is directed at eliminating export subsidization practices. The transparency of government assistance to enterprises is ensured by the annual provision of information to other parties on total amounts, distribution, specific cases and schemes of granting public assistance. In accordance with Article XIX of GATT (1994) and the WTO Agreement on Safeguards, a temporary application of protective measures in mutual trade in manufacturing and agricultural goods is allowed in the case of a threat of causing damage to domestic producers.

Parties agreed to freeze export duties at current levels and to start negotiations on their gradual cancellation within six months after entry into force of the FTZ Agreement. The parties also agreed not to use technical, sanitary and phytosanitary measures as barriers to trade. The Agreement documents a cancellation of quantitative restrictions in mutual trade between the CIS states in the form of quotas, licenses or other measures; in other words, non-tariff restrictions are completely cancelled. Notably, the Agreement also provides for mutual granting of national treatment in terms of internal taxes and levies, laws and rules regulating purchases and sales, shipments, distribution, use and processing of goods at domestic markets.

Most CA countries have acceded to a standard free trade regime conforming with WTO norms. Five countries of the region are members of the FTZ Agreement (Russia, Kazakhstan, Kyrgyzstan, Uzbekistan and Tajikistan). Turkmenistan is beyond the EurAsEC zone, and has a framework agreement on free trade with Russia (1992). Trade relations between Russia and Afghanistan are shaped in accordance with general practice.

To protect domestic markets and provide reciprocal measures to external discriminatory and other actions infringing upon the interests of manufacturers, several countries of the region still use non-tariff regulations. Since 2008, Kazakhstan has used tax instruments to regulate alcohol imports from Russia. Until January, 2010 Uzbekistan restricted motor vehicle imports in M2, M3 and N2 categories<sup>21</sup> based on technical barriers.<sup>22</sup>

<sup>20</sup> The procedure requires parties to establish an independent commission of experts. Previously, in the absence of multilateral mechanism, trading disputes between Russia and CIS countries were resolved bilaterally, and frequently by political means. Special safeguard investigations against Russian goods were initiated in 2008-2009 by Kazakhstan (confectionery, cotton-wool and roofing materials) and Kyrgyzstan (white sugar and flour) (see Kulik et al., *Ekonomicheskie interesy...*).

<sup>21</sup> Buses, trolley-buses and small trucks.

<sup>22</sup> Kulik et al., *Ekonomicheskie interesy...*

**FTZ and export protection:** A key feature of the FTZ Agreement is its orientation towards protection of markets of CU members<sup>23</sup> from exports from countries with low import barriers. The concluding article of the Agreement provides for a possible introduction of import duties at a most favored nation rate for specific commodities, in case one of the Parties enters into agreements with third countries resulting in an “increase of imports to the extent that causes damage or threatens to cause damage to the industry of CU.”<sup>24</sup>

The protective orientation of the CIS FTZ Agreement is indicated by the fact that Russia still retains about 100 export duty exemptions from the free trade regime. These exemptions include crude oil and oil products (with duty rates calculated according to a special formula), natural gas (30 %), and liquefied natural gas (€40 per ton). Duties on exports of petrochemicals, raw wood, nonferrous metals, cement, alcohol, shellfish, tuna and sunflower seeds are also retained. This list approximates the catalog of exemptions that Russia counts on when joining WTO. As in WTO, the FTZ Agreement contains an obligation to waive these exemptions in the future. Notably, the CIS free trade regime exempts industrial assembly of passenger cars in Russia until December 31, 2020, i.e. the same date as in the case of RF entering WTO.

Kazakhstan retained over 40 exemptions from the Agreement, including crude oil (calculated by special formula), natural gas (30 %), aluminum (15 %, but no less than €100 per ton). Tajikistan retained 16 export items, including meat, vegetables, raw cotton, electric power, leather and aluminum.<sup>25</sup>

The retention of protective barriers is a provisional measure, mostly likely aimed at maintaining the potential for cooperation and mutual trade against the background of changing trade regimes between FTZ parties and third countries. Cancellation of export duties is planned within the CES framework.

### 3.2. Customs duties in relations with third countries

Overall, the level of tariff protection of CA countries is relatively low. Customs and tariff regimes of the countries that previously were part of the Soviet Union diverged considerably since independence, ranging from very liberal in Kyrgyzstan, to fairly liberal in Kazakhstan and Tajikistan, and to restrictive in Uzbekistan.

The end of 2000s was characterized by an appreciable liberalization of a trade regime in Russia. In 2008, Russia retained a rather high level of external tariff protection that produced real advantages for CIS partners. The average import tariff in RF was 11 %, compared to 8

<sup>23</sup> The FTZ Agreement was the first treaty in international law that gave the CU international recognition. The Agreement clearly indicates that both member states and the CU (Russia, Belarus and Kazakhstan) enjoy equal rights.

<sup>24</sup> Russian Deputy Minister of Economic Development, A. Likhachev, acknowledged that this provision is aimed against countries that can conclude and/or implement free trade zone agreements with EU countries (see T. Ivzhenko, “Yanukovich okazalsia vne igry Putina”, *Nezavisimaya gazeta*, March 23, 2012, [http://www.ng.ru/cis/2012-03-23/7\\_yanukovich.html](http://www.ng.ru/cis/2012-03-23/7_yanukovich.html)).

<sup>25</sup> O. Sapozhkov and D. Butrin, “TS zashchitil sebia ot VTO v zone svobodnoy trgovli SNG”, *Kommersant*, November 14, 2011, <http://www.kommersant.ru/doc-y/1815767>.

% in Tajikistan, 6 % in Kazakhstan and less than 5 % in Kyrgyzstan. By 2010, the situation changed substantially and a trend towards convergence between tariff protection levels of countries in question became evident. Average external tariff protection in Russia dropped to 9.5 %, while in Kazakhstan it grew considerably. The proportion of duty-free non-agricultural import items to Russia also increased, while in Kazakhstan it contracted. In Russia, import tariffs on general engineering products and electrotechnical and electronic equipment were reduced considerably within a short period (see Table A.3).

A reduction of tariff protection in Russia, which is expected as a result of its accession to WTO,<sup>26</sup> would create a situation for CA countries when they would have to experience more tangible competition on the Russian market due to third countries. Meanwhile, custom-free access to the large and growing market of Russia is vitally important for its regional partners. Taking into account the fact that the majority of CA countries considerably lowered traditional tariff and non-tariff barriers, a low level of intra-regional trade could be related not just to the lack of export resources, but, according to international experts, to institutional roadblocks as well. Most CA countries have low ratings of international trade indicators, in particular by the number of documents, cost and time required to export and import (see Table 5). Costs related to exports or imports are also noticeably higher than in other transition economies.<sup>27</sup>

### 3.3. Trade regimes in non-EurAsEc member CA countries

**Turkmenistan:** The level of import tariff protection in Turkmenistan is generally low; in 2010, an average tariff value was 6.1 %, and a percentage of duty-free items in the total number of import items amounted to 80.1 %. At the same time, the country widely practices increased excise rates (sometimes significantly, compared to internal ones) on some imported goods to protect Turkmen manufacturers. Excise rates for some imported Russian goods substantially exceed those for similar goods of Turkmen manufacture established by local regulating bodies; the excise rate for malt beer is five times higher, and for other alcoholic beverages ranges from 2.5 to 6 times higher. Excise tax is also applied to imported Russian tobacco products and passenger cars. The use of differentiated excise rates results in the reduced competitiveness of excisable Russian products compared to Turkmen products, leading to their displacement from the market of Turkmenistan. Non-tariff regulations in Turkmenistan include licensing guidelines as well, based on a 2008 law "On licensing specific activities," including the import and sale of alcohol, alcoholic and tobacco products, chemical products and motor vehicles.

Commodity imports from Russia are in part regulated by a 1992 bilateral agreement on free trade between Turkmenistan and Russia, with exemptions formalized by annual agreements. Free trade between Russia and Turkmenistan de facto operates with major restric-

<sup>26</sup> According to ECE estimates, Russia's accession to WTO would result in a reduction of an average level of tariff protection to 7.5-7.8 % in 2012, compared to 10 % at the end of 2011 (see "Novye poshliny v svyazi so vstupleniem RF v VTO stanut izvestny v mae", April 11, 2012, <http://ria.ru/economy/20120411/623178515.html>).

<sup>27</sup> International Monetary Fund, *Regional Economic Outlook: Middle East and Central Asia* (Washington, DC: IMF, April 2011).

tions. Consultations with the Ministry of Trade and Foreign Economic Relations and Ministry of Finance of Turkmenistan concerning the alignment of excise rates on Turkmen goods and similar Russian products have produced few results so far.

In accordance with the enactment by the President of Turkmenistan of 2008, export duties are applied to handmade carpets, some mineral fertilizers, nonferrous metals and products thereof, wheat, wheat flour, pasta, and rice. Quantitative restrictions are also applied (including a total ban on exports of some commodities, such as oxygen tanks) to several agricultural products such as vegetables and fruits, with seasonal export patterns. All products exported from Turkmenistan are subject to compulsory certification.<sup>28</sup>

**Afghanistan:** Afghanistan has unique economic relations with Russia; a trade regime in this country just began to take shape during the past decade. Here, mostly for religious reasons, import bans for a significant number of commodities still persist, and seasonal restrictions, quotas and other non-tariff barriers are used. However, licensing requirements are noticeably streamlined, and the process of obtaining import licenses was also made easier. On the whole, the country's foreign trade policy is being shaped as a liberal one; the average import tariff was just 5.6 % in 2010. However, the proportion of duty-free import items in the total number of import items was as low as 0.5 %.<sup>29</sup> In 2004, Afghanistan applied for membership in WTO.<sup>30</sup>

In 2011, Russia became the major exporter of petroleum products to Afghanistan, following an oil embargo by Iran that on political grounds blocked, and later on limited the supply of petroleum products. However, Russian exports to Afghanistan are not stable, due to Iranian smuggling of cheap low-octane gasoline that expensive oil products from Russia cannot compete with. Trade between Russia and Afghanistan is also negatively affected by increased customs duties introduced by Afghanistan in May, 2011. The duty on oil products is USD 60 per ton; on liquefied gas, – USD 7 per ton; on flour, USD 10 per ton. Since Russian imports are mostly legal, increased duties lead to higher prices rises on the Afghan market for goods from CIS countries, which in turn lead to the rapid replacement of these goods by contraband deliveries from the southern and western directions.<sup>31</sup> The southern corridor (through the Afghan-Pakistan border) currently has a big advantage over the northern transit route, since 60 % of goods passing through the former are contraband, and an increase of import duties does not, as a rule, affect the volume of commodity flows. In turn, deceleration, for various reasons, of cargo movement through the territory of Uzbekistan has also resulted in a growth of contraband imports from Pakistani territory.<sup>32</sup>

<sup>28</sup> RF Ministry of Economic Development. Portal of foreign economic relations. "Turkmenistan. Protsedury dostupa na rynek", n.d., accessed February 27, 2012, [http://www.ved.gov.ru/exportcountries/pages/market\\_access/countries/211](http://www.ved.gov.ru/exportcountries/pages/market_access/countries/211).

<sup>29</sup> Ana Lucía Coronel et al. "Trade in CAREC Countries: Proposal for a study on trade in the region to assess need for revisions in Trade Policy Strategic Action Plan". Joint TPCC Project by the IMF and the World Bank, November 21, 2011, <http://www.carecprogram.org/uploads/events/2011/15th-TPCC/CAREC-Study-Proposal-Trade-in-CAREC-Countries-ru.pdf>.

<sup>30</sup> Veronica Bacalu, "Trade Taxes in CAREC Countries", Background Paper for the CAREC TPCC Meeting, September 2006, <http://www.carecprogram.org/uploads/docs/Trade-Taxes-CAREC-Countries.pdf>.

<sup>31</sup> CISA Expert Group, "Rossiisko-afganskaya ekonomicheskaya deyatel'nost' v 2011 g", July 5, 2011, <http://www.afghanistan.ru/doc/20419.html>.

<sup>32</sup> M. Daud, "Afganskije transportnye proekty stanovyatsya lokomotivami novoi regional'noi integratsii", June 9, 2011, <http://afghanistan.ru/doc/20259.html>.

### 3.4. Trade regime in the CU: Evolution of a unified commodity market

While the CU officially started to function on January 1st, 2010, it did not practically begin operating until July, 2010, when the new common Customs Code (CC) entered into force, and all controls in trade between CU members were abolished, including customs, transport, sanitary-quarantine, veterinary and phytosanitary controls. The common CC introduced the new notion of a “single CU customs territory”, established unified terms of customs transit for this territory, abolished customs clearance in mutual trade and eliminated (step by step) border customs controls for goods originating from the territories of CU member states, as well as for goods from third countries released for free circulation at the single customs territory.

Changes in the trade regime between Russia and Kazakhstan began in January, 2010, when the common customs tariff entered into force and the CU Commission began its practical activities. Uniform mechanisms of foreign trade regulation were introduced, and controls at the Russian-Kazakhstan border were simplified. The CU member countries undertook to refrain from the use of non-tariff restrictions. The mechanism of transfer and distribution of import customs duties came into operation in September 2010; Kazakhstan’s quota was established at 7.33 %, Belarus’s quota at 4.7 %, and Russia’s quota at 87.97 % of total CU import customs duties.<sup>33</sup>

Some issues have emerged. The formation of the CU led to the appearance of problems on its external borders. Establishing a single customs border has complicated shuttle trade, which is traditional for neighboring, non-CU, CA countries. Observers point out that CU hinders the development of trade between China and Kazakhstan and impedes the re-export of Chinese consumer goods from Kyrgyzstan to Kazakhstan and Russia.<sup>34</sup> Currently, the effects of CU establishment for this trade are unclear, as the scope of this trade is very difficult to measure.

According to Russian official representatives, Russia should be assured that goods entering the country of any FTZ member would not be re-exported duty-free to the CU territory under the guise of own goods. Kyrgyzstan has a simplified customs regime with China. Officially declared trade flow between the two countries is as low as USD 0.5 billion, but the real volume of Chinese exports to Kyrgyzstan during the past years was estimated to reach USD 7 billion.<sup>35</sup> Chinese consumer goods, mainly clothes and footwear, are delivered to the CU territory under the guise of Kyrgyz goods. That is why Russia, as a CU member, was compelled to raise an issue of tightening the customs regime at the Kazakhstan – Kyrgyzstan border, where all the commodities currently pass strict control for rules of origin.<sup>36</sup> This has led to a strained

<sup>33</sup> Kulik et al., *Ekonomicheskie interesy...*

<sup>34</sup> Yevgeny Vinokurov, “Otkrytyi regionalizm v Evrazii: ot postsovetskoi k evraziiskoi integratsii” (paper presented at the 13th April International Academic Conference on the Problems of Economic and Social Development, Moscow, April 3-5, 2012).

<sup>35</sup> S. Yu. Glaz’ev, «Vzryvnye» lastochki Tamozhennogo soyuza” (an interview to RGRK «Golos Rossii», August 2, 2011), [http://rus.ruvr.ru/radio\\_broadcast/6320486/54058901.html](http://rus.ruvr.ru/radio_broadcast/6320486/54058901.html).

<sup>36</sup> Ibid.

situation at the Kyrgyzstan – Kazakhstan border, due to difficulties that Kyrgyz clothing manufacturers experience when exporting their products.<sup>37</sup>

The unification of trading regimes within CU involves a problem of their unification with those of other FTZ members as well. The accession of Kyrgyzstan and Tajikistan, the two EurAsEC members that signed the FTZ Agreement, to the integration nucleus, the CU, serves the interests of both these states.

At an informal summit in Almaty in December 2009, the presidents of Belarus, Kazakhstan and Russia endorsed the action plan for the transition to a new stage of integration and the formation of a Common Economic Space (CES) for the three countries and the Eurasian Economic Union. The documents forming CES were signed in December 2010, ratified by all the parties and came into effect in January 2012. The adoption of these documents and the implementation of obligations assumed under these agreements by all the parties would provide, from January 2016, for the full-fledged operation of CES. The CES action plan differs from a free trade regime in that it allows for the free and unimpeded movement of not just goods, but of services, people and capital as well.

In the experts' opinion, the Eurasian Economic Union evolving on the basis of the CU is a "solid and real integration perspective."<sup>38</sup> However, member states of the new integration alliance would have to accept a certain derogation of their sovereignty. This could lead to conflicts between the interests of groups of national elites within potential EAEU member states – from national interests as such to lobbyist and at times corrupt ones.

### 3.5 Technical regulation and control measures

When integration associations are formed, participating countries need not only to mutually adjust their trade regimes, but to jointly regulate the processes of interaction of national economies, and ensure favorable conditions for market participants. These measures include coordinated transport tariff policies, establishing a uniform system of antimonopoly regulation and arbitration, and mutual recognition of licenses. Important spheres requiring regulation include technical standards, sanitary, veterinary and phytosanitary measures.

In 1992, CIS members signed an agreement on implementation of coordinated policy in the field of standardization, metrology and certification. Two organizations were established within the CIS framework, the Intergovernmental Council on Standardization, Metrology And Certification (ICS) and the Council on Technical Standardization in the Construction field (CTSC). As a result, CIS countries currently possess an extensive stock of intergovern-

<sup>37</sup> Yu. Krivoshepko, "«Troika» stanet kvartetom. V 2012 godu k Tamozhennomu soyuzu mozhet prisoedinit'sya Kirgiziya", *Rossiiskaya gazeta*, № 5640 (264), November 24, 2011, <http://www.rg.ru/2011/11/23/kirgizia-site.html>.

<sup>38</sup> Viktoriya Panfilova, "Otlojennaya partiya Islama Karimova. Tashkent ne speshit v Evraziiskii soyuz i jdet itogov prezidentskih vyborov v Rossii", *Nezavisimaya gazeta*, December 8, 2011, [http://www.ng.ru/cis/2011-12-07/1\\_karimov.html](http://www.ng.ru/cis/2011-12-07/1_karimov.html).

mental standards (including 20570 regulatory documents): their rate of harmonization with international and European standards (ISO/CEN)<sup>39</sup>, approaches 40 %.<sup>40</sup>

Within EurAsEC, members signed an agreement on the implementation of coordinated policy in the field of technical regulation, sanitary and phytosanitary measures (January 25, 2008). The evolution of the CU has put on the agenda the development of the agreement on uniform principles and rules of technical regulation between the Republic of Belarus, Republic of Kazakhstan and the Russian Federation, which was signed in November 2010 and came into effect for Russia since July 2011.<sup>41</sup> The major substantive provisions of this agreement are:

- CU technical regulations have direct application throughout the entire territory of CU;
- Products covered by the CU technical regulations are released into circulation provided they passed through the procedures of conformity assessment (validation), in the form of registration, testing, expert appraisal or in other forms, established by CU technical regulations;
- An obligatory validation of products' conformity to the CU technical regulations is carried out in the form of declaration of conformity or certification;
- Products that conform to CU technical regulations' requirements and passed conformity assessment procedures should be labeled by a single mandatory conformity mark for products placed on the market in CU territory;
- If products conform to CU technical regulations, parties to the Agreement cannot impose additional requirements or establish assessment procedures for releasing those products into circulation in their respective territories;
- CU technical regulation, or part thereof, ceases to be effective from the date of entry into force of EURAsEC technical regulation for similar products.

The Agreement provides that CU technical regulations are developed and adopted exclusively for the purpose of protecting the life and health of persons, animals and plants; protecting property and the environment; and preventing actions that misinform consumers. Additionally, they can be developed for the purposes of energy conservation and the efficient use of resources. Adoption of CU technical regulations for other purposes is prohibited.

This approach corresponds to the pattern of technical regulations adopted by the EU and allows for the adoption of production safety regulations which are phrased in general terms, giving manufacturers the freedom to choose the ways and means of achieving safety

<sup>39</sup> International Organization for Standardization / European Committee for Standardization.

<sup>40</sup> A.V. Zazhigalkin, "Natsional'naya sistema standartizatsii: sostoyanie i perspektivy razvitiya" (presentation at the Conference on The Establishment of CU Technical Regulation System, Moscow, April 18-21, 2011), [www.tk322.ru/download/Zazhigalkin\\_TK\\_322.pps](http://www.tk322.ru/download/Zazhigalkin_TK_322.pps).

<sup>41</sup> Apart from this framework agreement, by mid-April 2012 seven additional agreements and 12 lower-level documents regulating CU technical policy were signed. The major ones include the Agreement on technical barriers in trade, the Agreement on mutual recognition of the accreditation of certification bodies, and the Agreement on phytosanitary measures. A list of 47 top-priority technical regulations was also defined; of these, 24 have been developed and adopted, and 14 are in the process of coordination. The regulations adopted cover 70 % of the articles mutually supplied within CU (see A. Kazimirko-Kirillova, "Chto zhdet Tamozhennyi soyuz posle VTO", April 13, 2012, [http://www.rgtr.ru/news/2012/04/13/news\\_1366.html](http://www.rgtr.ru/news/2012/04/13/news_1366.html)).

of their products. The European standards are voluntary rather than mandatory, but if a company chooses not to use the generally accepted voluntary standard it has to prove, at its own expense, that the safety level of its products conforms to the requirements of the corresponding EU Directive. This approach was used when the CU system of technical regulations was developed.<sup>42</sup>

Under the Agreement, the parties assumed an obligation to generate a uniform list of products that fall under mandatory requirements within CU. A list of 61 products was approved by a decision of the Customs Union Commission (CUC) of January 28, 2011. Article 8 of the Agreement specifies which organisations are entitled to carry out the assessment (validation) of the products' conformity to CU technical regulations.

It is envisaged that national technical regulations regulating the same articles as the CU/EurAsEC technical regulations would gradually be cancelled as the latter come into effect, and that parties would cease to develop national regulations that parallel those at the inter-governmental level.

When establishing this system of technical regulation, CU member countries assumed that the system would apply not only to EurAsEC members (Kyrgyzstan and Tajikistan), but to other CIS members as well, including Uzbekistan and Turkmenistan. This assumption was strengthened by the fact that conformity to CU technical regulations is based on international and intergovernmental standards (including CIS intergovernmental standards which are available to any country in post-Soviet territory). If they are not yet adopted, the best available national standards, harmonized with European requirements, are used.

## 4. Investment and industrial cooperation

### 4.1. Mutual investment flows

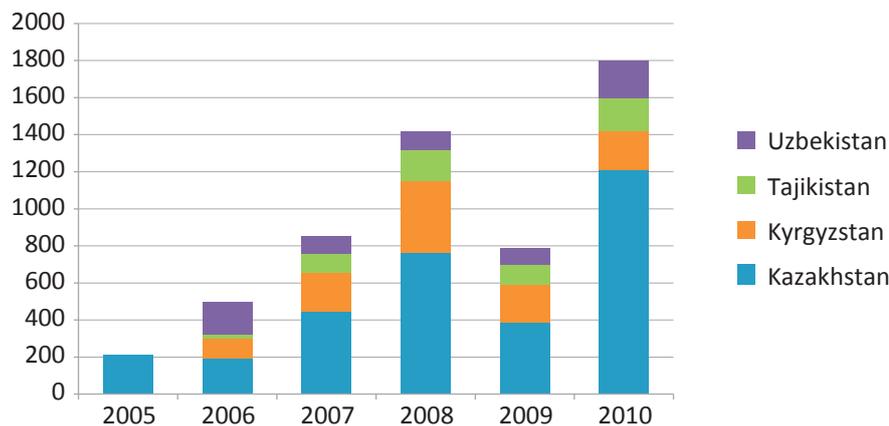
Investment cooperation between Russia and CA countries is developing at a fast pace. Even according to grossly understated Rosstat data,<sup>43</sup> the cumulative stock of Russian investments in CA countries at current prices has grown (despite the crisis) 4.4 times during 2005-2010, while annual investment flows increased 2.2 times (Figure 10). Aggregate investments of

<sup>42</sup> V.Yu. Salamatov, "Tamojennyi soyuz - novye vozmozhnosti integracii i vnedreniya innovacionnyh reshenii na postsovetском prostranstve", November 23, 2011, <http://www.minpromtorg.gov.ru/industry/metrology/88>.

<sup>43</sup> Rosstat data, which are repeatedly adjusted, do not register all real investments. They include only investments of non-financial enterprises, do not take into account re-investments or assets acquisition at the secondary market which can substantially exceed initial investments. A considerable proportion of Russian companies' investments is administered through foreign business structures, and official statistics refer these to corresponding foreign jurisdictions. According to Rosstat, 93-100 % of Russian investments in CA countries fall under the "Miscellaneous" category, including trade loans, loans from international financial organisations and foreign governments' loans obtained against security of the RF government. The same applies to CA investments into the Russian economy.

CA countries into the Russian economy increased 1.5 and 2.2 times accordingly (Figure 11). Analysis of available national statistics demonstrates that figures of investment flows in specific countries vary significantly from year to year. In certain years, as a result of large transactions or intergovernmental agreements, inflows of investments increase tens or even a hundreds times, and then return to previous levels.

**Figure 10. Inflows of Russian investments into CA economies (USD million)**



*Note: Includes all types of investments: direct and portfolio investments, miscellaneous investments (trade and other loans, including foreign governments' loans obtained against security of the RF government), and excludes investments by monetary authorities, commercial and saving banks.*

*Source: Rosstat data for corresponding years*

Available data suggest that investment flows between Russia and CA countries are continuously growing. At the same time, the absolute size of this cooperation is still small. A relatively measurable interaction can be traced mostly in Russia-Kazakhstan relations, as well as in specific sectors of the economy such as energy sector, ores and metals, and telecommunications. In Kazakhstan and Kyrgyzstan, where relevant national statistics are available, Russia's proportion in total foreign investment stock increased in the 2000's, but still remains low compared to its share in foreign trade turnover of the same countries.

According to Kazakhstan national statistical agency, Russia ranked 6<sup>th</sup> among foreign partners, accounting for only 3.7 % of the total inflow of foreign direct investment (FDI) to the country in 2010, 0.6 percentage points (p.p.) less than in 2007. Regarding accumulated FDI stock in Kazakhstan, Russia, with its share of 1.4 % (USD 3.5 bn), was not even one of Kazakhstan's top ten foreign partners in 2010. Still, there are approximately 6,000 enterprises with Russian capital operating in Kazakhstan, which is more than at the rest of the post-Soviet space outside Russia. This is not due to intensive cooperation efforts, but rather to the specific role firms from border regions are playing; in Kazakhstan, they account for over two-fifths of total trade turnover with Russia.<sup>44</sup>

Similarly, in Kyrgyzstan, throughout the second half of the 2000s, Russia ranked 5<sup>th</sup> or 6<sup>th</sup> by total FDI inflow, and it was only in 2010 that Russia placed second (USD 97.4M) after Canada

<sup>44</sup> B.A. Heifets, *Rossiyskiy biznes v stranah EvrAzEs: modernizatsionnyi aspekt*. Moscow: Ekonomika, 2011.

(USD 205.4M) by this measure. This was probably the result of large-scale Russian government aid for restoring the Kyrgyz economy after the events of April and July, 2010.<sup>45</sup> Russia ranks only 7<sup>th</sup> (after Kazakhstan, UK, Germany, China, Turkey and the USA) in total accumulated stock of FDI in the economy of Kyrgyzstan.

Conversely, in Uzbekistan and Tajikistan, Russia ranks first (or one of the first) by accumulated FDI stock. According to Tajikistan Statistical Agency, Russian companies directly invested over USD 380 million into the Tajik economy from 2005 to 2010,<sup>46</sup> and there are over 60 joint ventures with Russian capital registered in Tajikistan. The accumulated stock of Russian FDI in Uzbekistan grew from USD 603.7M in 2009 to USD 688M in 2011, accounting for about a fourth of FDI inflow into the country,<sup>47</sup> and 848 firms, in partnership with Russian companies, are currently operating in Uzbekistan; about a fourth of these (210 firms) were established during 2008 – 2010. The total size of Russian investments in shaping their statutory capital amounted to about USD 500M.<sup>48</sup>

Investment cooperation between Russia and Turkmenistan and Afghanistan is much less intensive. According to the CIS Intergovernmental Statistical Committee, total accumulated stock of Russian investments in Turkmenistan was just USD 1.6M in early 2011. These investments are comprised primarily of loans provided mostly to finance communications and transport development projects in Turkmenistan. Except for the oil and gas sectors, there are no significant joint Russian-Turkmenistan investment projects. FDI from Turkmenistan into the Russian economy is also absent.<sup>49</sup> According to the Russian-Afghani Business Council, Russian companies are only investing USD 10M annually (overall, about USD 40M during 2007-2010) into Afghanistan, and primarily finance small projects with fast returns. This is due to high long-term business risks in Afghanistan, related to security after the withdrawal of foreign troops, and political instability.<sup>50</sup>

<sup>45</sup> National Statistical Committee of the Kyrgyz Republic, *Deyatel'nost' predpriyatii s inostrannymi investitsiyami v Kyrgyzskoi Respublike, 2006-2010* (Bishkek: National Statistical Committee, 2011), [www.logincee.org/file/24897/library](http://www.logincee.org/file/24897/library).

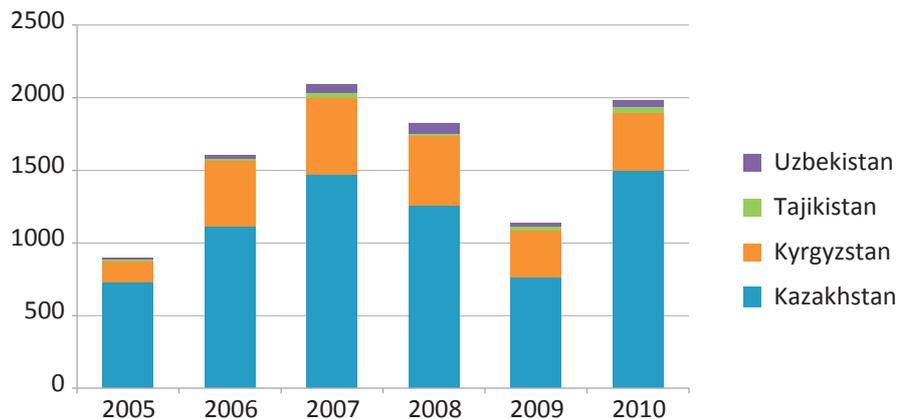
<sup>46</sup> N. Safarov, "Tadzhikistan: trgovlya i investitsii v 2010 godu", December 3, 2010, <http://almaz2002.livejournal.com/16284.html>.

<sup>47</sup> RF Ministry of Economic Development. Portal of foreign economic relations, "O deyatel'nosti po prodvizheniyu investitsionnyh i innovatsionnyh proektov rossiiskih kompanii v Uzbekistane" (n.d.), accessed February 20, 2012, [http://www.ved.gov.ru/exportcountries/pages/rus\\_projects/countries/214](http://www.ved.gov.ru/exportcountries/pages/rus_projects/countries/214).

<sup>48</sup> Ministry of Foreign Economic Relations, Investments and Trade of the Republic of Uzbekistan, "Torgovo-ekonomicheskoe i investitsionnoe sotrudnichestvo Respubliki Uzbekistan s Rossiiskoi Federatsiei" (n.d.), accessed February 21, 2012, [http://www.mfer.uz/rus/mejdunarodnoe\\_sotrudnichestvo/sotrudnichestva\\_s\\_zarubejnimi\\_stranami/sotrudnichestva\\_s\\_stranami\\_sodrujestva\\_nezavisimix\\_gosudarstv\\_sng/rossiyskaya\\_federaiya/](http://www.mfer.uz/rus/mejdunarodnoe_sotrudnichestvo/sotrudnichestva_s_zarubejnimi_stranami/sotrudnichestva_s_stranami_sodrujestva_nezavisimix_gosudarstv_sng/rossiyskaya_federaiya/).

<sup>49</sup> RF Ministry of Economic Development. Portal of foreign economic relations. "Turkmenistan. Obzor deyatel'nosti po prodvizheniyu investitsionnyh i innovatsionnyh proektov," (n.d.), accessed March 03, 2012, [http://www.ved.gov.ru/exportcountries/pages/rus\\_projects/countries/211](http://www.ved.gov.ru/exportcountries/pages/rus_projects/countries/211).

<sup>50</sup> CISA Expert Group, "Rossiisko-afganskaya..."

**Figure 11. Inflows of investments from CA countries into the Russian economy (USD million)**

Note: Includes all types of investments: direct and portfolio investments, miscellaneous investments (trade and other loans, including foreign governments' loans obtained against security of the RF government), and excludes investments by monetary authorities, commercial and saving banks.

Source: Rosstat data for corresponding years

Regarding reverse investment flows, business from CA countries have had enhanced their impact on the Russian economy during the last pre-crisis years. Of particular significance are Kazakh investments which accounted for over three-fourths of total CA investments and ranked first among CIS country investments in Russia in 2010 (Figure 11). However direct investments remain small. The growth of Kazakhstan investments into Russia was fostered not just by economic overheating due to high oil revenues, but by their support at the highest governmental level. Major sectors of Kazakhstan investments in Russia are banks and finance, construction and real estate, and retail trade.<sup>51</sup> Low investment by Uzbek companies in foreign markets is due to national currency regulations that do not allow capital exports, as well as to inconvertibility of local currency. Additionally, the majority of large Uzbek firms are either entirely or partially owned by the state. Investments flows from Afghanistan to Russia in 2010 were comparable to Russian investments into this country and amounted to USD 7.9 bn.

## 4.2. Investment sectoral structure

Russian capital in Central Asia is concentrated mainly in the *production of energy resources*, specifically oil and natural gas. Though exact data are lacking, the volume of Russian investments in this sector during the pre-crisis period (2006) was estimated at a modest (compared to other international actors) USD 4-5 bn, of which 80 % was invested in Kazakhstan and 10 % in Uzbekistan. Prior to the crisis it was assumed that Russian companies would increase their financial presence in Central Asia to USD 15 bn by 2012, mostly in the development of transport and logistic infrastructure.<sup>52</sup>

<sup>51</sup> Kazakh company Capital Partners, affiliated with Kazkommertsbank, built the Ritz-Carlton Hotel in Moscow, which was then sold to Kazakh investment company True Capital in 2011. The largest (pre-crisis) private banks of Kazakhstan, BTA-Bank and Kazkommertsbank, created a network of affiliate banks in Russia which are mostly involved in real estate credits and mortgage loans.

<sup>52</sup> Laruelle, "Russia in Central Asia".

In Kazakhstan, Russian company LUKOIL is active in as many as seven oil and gas onshore production projects<sup>53</sup> and three offshore exploration projects in the Kazakhstan sector of the Caspian shelf.<sup>54</sup> Currently, Kazakhstan accounts for approximately 40 % of the company's proven reserves; projects in Kazakhstan provide over 90 % of oil and over 40 % of natural gas produced by LUKOIL outside of Russian territory. LUKOIL is also a major shareholder (12.55 %) of the Caspian Pipeline Consortium and is involved in wholesale trade of oil products. Since 1995, LUKOIL has invested over USD 6 bn into the Kazakh economy, including USD 360M both in 2010 and 2011.<sup>55</sup>

Another large Russian oil company, Rosneft, operating in Kazakhstan under "RN – Exploration" brand, has been less successful in its operations in Kazakhstan so far. In 2005, it has signed a Production Sharing Agreement (PSA) on Kurmangazy prospective structure on the Caspian shelf at the Russia – Kazakhstan border for 55 years, with recoverable reserves of oil estimated at 0.5 – 1.8 billion tons. However, exploratory drilling from 2006-2009 revealed no signs of hydrocarbons.<sup>56</sup> In 2011, Rosneft terminated a PSA on exploration and development of the Adai field in the Atyrau region because further prospecting was deemed unpromising.<sup>57</sup>

The future of a large joint project on processing natural gas from the Kazakh deposit Karachaganak at the Orenburg gas-processing plant (GPP) by Gazprom and the Kazakh company KazMunaiGaz is also under threat. This is due to a decision by President Nazarbaev in January, 2012, to start the construction of home-based GPP at Karachaganak to "do away with dependence on gas..., no matter how much it costs us."<sup>58</sup> Guaranteed annual deliveries of no less than 15 billion cubic m of Karachaganak gas to Orenburg were one of the pre-conditions of joint venture operation put forward by the Russian side. However, even the third stage of Karachaganak project development that Karachaganak Petroleum Operating Consortium is about to start, envisages gas production of a maximum of 16 billion cubic m a year. A new GPP at Karachaganak would therefore hamper Kazakhstan's ability to supply to Orenburg the amount of gas required for the joint venture.<sup>59</sup>

In Turkmenistan, Russia's interests are limited to the natural gas sector. ITERA is the only Russian company directly participating in the development of Turkmen energy resources, although both LUKOIL and TNK-BP are trying to find their way into the Turkmenistan market. Russia's presence remains limited, as Ashgabat allows foreign investment only in offshore gas fields which are more cost-intensive and technically difficult to develop.<sup>60</sup> Since

<sup>53</sup> Oil-and-gas fields Arman, Karakaduk, Northern Buzachi (Mangistau Province), Karachaganak (Western Kazakhstan Province), Kozhasai and Alibekmola (Aktubinsk Province), Kumkol (Kyzylorda Province).

<sup>54</sup> "LUKOIL otkazalsya ot dvuh iz treh proektov po geologorazvedke na shel'fe Kazakhstana", August 17, 2011, <http://www.newskaz.ru/economy/20110817/1806238.html>.

<sup>55</sup> "LUKOIL vlozhit v Kazahstan v 2011 g. tret' milliarda dollarov", July 5, 2011, <http://www.vestifinance.ru/articles/168>.

<sup>56</sup> "Grezy vokrug odnogo El'dorado. "Rosneft" sobiraetsya uiti iz kazahstanskogo super-nefteproekta Kurmangazy", May 26, 2009, <http://www.centrasia.ru/newsA.php?st=1243311840>.

<sup>57</sup> E. Butyrina, "Rosneft'» i Sinopec vyshli iz SRP po proektu Adaiskogo bloka", June 27, 2011. <http://www.nomad.su/?a=4-201106270014>.

<sup>58</sup> "Postroiv GPZ na Karachaganake, Kazahstan vyrazit svoe otnoshenie k Tamozhennomu soyuzu", January 31, 2012, <http://www.rusenergy.com/ru/news/news.php?id=57638>.

<sup>59</sup> Ibid.

<sup>60</sup> Laruelle, "Russia in Central Asia".

the international legal status of the Caspian Sea remains uncertain, these deposits are also complicated from a geopolitical viewpoint. Russia-Turkmen cooperation is limited to exports of Turkmen gas to Russia via the Center-Central Asia pipeline, which suffered from an explosion in 2009 and a subsequent fourfold reduction of gas purchases (11 billion cubic m) by Gazprom in 2010, which has since ceased to be the major consumer of Turkmen gas.<sup>61</sup>

In 2010, Uzbekistan, for the first time, led CA countries in the size of contracts for natural gas deliveries (15.5 billion cubic m) to Russia. The two largest Russian companies, LUKOIL and Gazprom, are not only involved in gas purchases in Uzbekistan, but develop their own production capacities as well. The two corporations, along with their affiliates, account for over 20 % of natural gas production in Uzbekistan, producing 13 out of 63 billion cubic m. In 2010, Russian investments into the country's oil and gas industry was estimated at over USD 2 bn, while Russian investments accounted for about 60 % of total foreign investment into the Uzbekistan economy.<sup>62</sup>

In Kyrgyzstan and Tajikistan, investments by Russian energy companies are represented primarily by Gazprom, which through its affiliated structures actually have a monopoly of the oil product markets of these countries.<sup>63</sup> Additionally, in 2010, Gazprom began exploration at three sites in Tajikistan (Sargazon, Western Shaambary and Sarykamysh). In 2011, it restarted prospecting two oil and gas fields (Kugart and Mailuu-Sai-IV) in Kyrgyzstan, with planned investments of over USD 100M, and is considering the acquisition of two Kyrgyz government-owned companies, Kyrgyzneftegaz and Kyrgyzgaz.<sup>64</sup>

Cooperation between Russia and CA countries, particularly Kazakhstan, in the sphere of *minimal resources development* is mutually advantageous. Kazakhstan possesses large and diverse mineral reserves, but its remoteness from major regional markets and seaways renders the export of raw materials noncompetitive. Russia, with sizeable processing capacities, and a shortage of some raw materials, serves as an important product market for Kazakhstan.

Of particular significance is bilateral cooperation in the nuclear sphere, based on two related interests: Russia's intention to access Kazakh uranium deposits, and Kazakhstan efforts to reconstruct the complete nuclear fuel cycle (NFC) in the republic, with a corresponding reduction in dependence on Russia. After the breakup of the USSR, Kazakhstan inherited only a fraction of NFC process stages; mining of natural uranium (as the world leader, mining almost 36 % of global production in 2011), affination or primary refining, and fuel pellets production. The remaining NFC stages are in Russian territory. Meanwhile, uranium oxide concentrate accounts for only 35 % of the total cost of fuel assembly, at about USD 1M.<sup>65</sup>

<sup>61</sup> V. Panfilova, "Turkmeniya vybila «Gazprom» s rynka Kitaya", *Nezavisimaya gazeta*, November 25, 2011, [http://www.ng.ru/cis/2011-11-25/7\\_gazprom.html](http://www.ng.ru/cis/2011-11-25/7_gazprom.html).

<sup>62</sup> G. Zhmarev, "Kak dal'she budut razvivat'sya rossiisko-uzbekskie ekonomicheskie otnosheniya?", March 5, 2012, <http://fincake.ru/blogs/hercy/posts/4467.html>.

<sup>63</sup> Gazpromneft – Tajikistan accounts for almost 90 % of oil product imports into the country. In February 2012, after Kyrgyz Parliament approval, two Gazprom subsidiaries have gained a monopoly right to duty-free imports of oil and oil products from Russia (85 % of the country's needs), and control over their distribution and consumption in Kyrgyzstan. See E. Balaeva, "Integratsiya vo imya Gazproma", February 29, 2012, <http://www.respublika-kz.info/news/politics/20998/>.

<sup>64</sup> "Gazprom» potratit 3 mlrd rublei na geologorazvedku v Kirgizii", September 7, 2011, <http://www.vesti.ru/doc.html?id=562275&tid=89698>.

<sup>65</sup> S. Smirnov, "Mirnyi atom Kazahstana", *Kazakhstan International Business Magazine*, no. 1 (2011), <http://www.investkz.com/journals/76/812.html>.

To become a vertically integrated company rather than just a supplier of natural uranium, Kazatomprom is incorporating the missing NFC links by constructing own capacities and through acquisition abroad. Within the framework of an integrated Russia-Kazakhstan cooperative programme, a joint center for uranium enrichment based on the world's largest enterprise in the industry, the Urals electrochemical integrated plant, will be organised in 2012. Kazakhstan will be allotted a certain equity share in this plant (about 30 % is under discussion).<sup>66</sup>

On its part, Russia consolidated its uranium production assets in Kazakhstan in March 2009. Russian uranium holding Atomredmetzoloto (ARMZ), which is part of the Rosatom corporation, acquired a 50 % block in Limited Liability Partnership (LLP) Karatau and 25 % in JSC Akbastau joint venture (JV); both companies are controlled by Rosatom through its subsidiary Effective Energy H.B. In 2009-2010, ARMZ acquired control over 51 % of Canadian Uranium One which in turn owns 70 % of Akdala and Inkai and 30 % of Horasan uranium minefields in Kazakhstan. As a result, JVs in Kazakhstan accounted for over 25 % of uranium produced by ARMZ in 2009, and this percentage is growing.<sup>67</sup> The cooperative scheme, Uranium mining in Kazakhstan – Enrichment in Russia, paves the way for bilateral collaboration in other related fields, such as establishing a single company for sales of natural and low-enriched uranium on the world market, and construction of nuclear power stations in Central Asia.

In 2007, Russian Renova Group won the tender for the acquisition, for USD 4M, of 72.23 % in the Kara-Balty mining plant, the largest CA enterprise for processing uranium ore and producing marketable uranium oxide concentrate. Renova is planning further development of the plant based on retreating existing tailings to obtain alternate uraniferous materials and to resolve environmental issues. Total investments are estimated at USD 30M.<sup>68</sup>

Other mining projects include the Russian company Mechel putting into service of the Voskhod-Chrom mining and processing plant in September 2008. The plant processes 1.3 million tons of chromium ore annually from the Voskhod deposit in Kazakhstan, since Mechel acquired the UK-based Oriel Resources for USD 1.5 bn in April 2008, which had owned the Voskhod deposit and the Shevchenko nickel and cobalt minefield in Kustanai province.<sup>69</sup>

Russian investors are also present in the Kazakhstan gold mining industry. Since 2007, the Severstal Group has been involved in the development of Kazakhstan gold deposits Suzdalskoe (100 %) and Zherekskoe (75 %), and in mining of molybdenum at Shorskoe minefield (50 %). In August 2008, Severstal acquired 100 % of the Kazakh Balazhal company that developed the Balazhal gold minefield at USD 25-30M.<sup>70</sup> Russian company Rusal and Kazakh

<sup>66</sup> «Rosatom»: reshenie po «Tsentru obogascheniya urana» budet prinyato v pervoi polovine 2012 goda», February 17, 2012, <http://pronedra.ru/atom/2012/02/17/rosatom/>.

<sup>67</sup> A.M. Asametova, E. Yu. Vinokurov, «Sotrudnichestvo Rossii i Kazakhstana v atomno-energeticheskom komplekse», *Industry Profile* No. 11 (Almaty: Eurasian Development Bank, 2011), [http://www.eabr.org/general/upload/docs/publication/analyticalreports/full\\_version\\_11\\_rus.pdf](http://www.eabr.org/general/upload/docs/publication/analyticalreports/full_version_11_rus.pdf).

<sup>68</sup> «Kara-Baltinskii gornorudnyi kombinat v 2009 godu proizvel 2574 tonn urana», January 29, 2010, <http://www.atomic-energy.ru/news/2010/01/29/8564>.

<sup>69</sup> V. Luk'yanchikov, «GMK Kazakhstana stanovitsya vse bolee russkim», *Kazakhstan International Business Magazine*, no. 5/6 (2008), <http://www.centrasia.ru/newsA.php?st=1238992740>.

<sup>70</sup> D. Smirnov, «Severstal» uglublyaetsya v Kazakhstan», *Kommersant*, August 12, 2008, <http://www.kommersant.ru/doc/1010437>.

company Samruk-energo continue to cooperate in the JV Bogatyr Komir in Ekibastuz, where they are developing two coal strip mines, Bogatyr and Severnyi, which account for about 69 % of Ekibastuz coal production. The two companies are implementing a program of technical re-equipment with a total investment of about USD 300M, and production capacity is expected to increase by 19 % to 50 million tons in 2018.<sup>71</sup>

In Kyrgyzstan and Tajikistan, large-scale cooperative investment projects with Russia are focused in *electric power generation*. The largest project in Tajikistan is the Sangtuda 1 hydroelectric power station (HPS) with a total capacity of 670 MW that was commissioned in July 2009. The Russian government and Russian companies Rosatom and Inter RAO UES own 75 % of Sangtuda 1 shares and have invested about USD 680M in its construction and Tajikistan invested approximately USD 120M.<sup>72</sup> Several other cooperative projects are either under discussion or in a suspended state. After the Tajik government revoked its contract with Rusal on the construction of the Rogun HPS in 2007, Tajikistan was not able to find other investors and embarked alone to implement the project at a cost of USD 2.2-2.5 bn. In Kyrgyzstan, Russia reconfirmed its readiness to invest over USD 2.1 bn into the construction of Kambarata-1 HPS in 2011. But the decision-making is delayed and turning over the construction to investors from Kazakhstan has been suggested.<sup>73</sup> Cooperation between Inter RAO UES, RusGidro and JSC Electric Stations of Kyrgyzstan in the construction of Naryn-1,2,3 hydropower projects and Akbulun HPS also remains unsettled. An important factor restraining Russian investment is Uzbekistan's opposition to hydropower construction in Tajikistan and Kyrgyzstan due to environmental threats caused by the possible reduction in the Amu-Darya and Syr-Darya Rivers runoff.<sup>74</sup>

Joint opportunities for investment in *machine building* and other manufacturing industries are also far from being exploited. The examples of such investment projects are few and these are not always successful. Among promising projects is a contract on the acquisition of shareholdings in Vostokmashzavod (Ust-Kamenogorsk) and in Kazakh Railcar Building Company (that owns a railcar plant in Ekibastuz) by Russian government-owned Uralvagonzavod (UVZ). The contract was signed with Kazakh government railroad operator KTZh in 2011. UVZ is planning to invest USD 200M into refurbishing these enterprises, enabling it to become the largest railcar producer in Kazakhstan.<sup>75</sup> The memorandum on the establishment of a joint venture on railcar production with Rusal is in the approval process with the Kazakh government.<sup>76</sup>

Russian AVTOVAZ and Kazakh ASIA AVTO signed a strategic partnership memorandum in November 2011, which outlines the establishment of complete-cycle manufacture of passenger cars from the AVTOVAZ lineup at a site in Eastern Kazakhstan province. The launch of

<sup>71</sup> "K 2018 godu proizvodstvennaya moschnost' «Bogatyr' Komir» uvelichitsya na 19%", September 27, 2011, <http://www.automan.kz/265464-k-2018-godu-proizvodstvennaja-moshhnost-bogatyr.html>.

<sup>72</sup> "Sangtudinskaya GES-1. Sdelano Rossiei dlya Tadzhhikistana", February 3, 2012, <http://blog.rushydro.ru/?p=5342>.

<sup>73</sup> "Kirgiziya predlozhila Kazakhstanu vystupit' tret'im partnerom v proekte stroitel'stva GES Kambar-Ata-1", February 22, 2012, <http://rosinvest.com/novosti/906032>.

<sup>74</sup> "IWPR: Uzbekistan pytaetsya pritormozit' energeticheskie plany Tadzhhikistana", April 4, 2011, <http://tjknews.com/?p=4442>.

<sup>75</sup> E. Popov and A. Panchenko, "UVZ zaedet v Kazakhstan. On rasschityvaet stat' tam krupneishim proizvoditelem vagonov", *Kommersant*, November 21, 2011, <http://kommersant.ru/doc/1820889>.

<sup>76</sup> "SP po proizvodstvu vagonov budet sozdano Kazakhstanom i rossiiskim "RUSALom", June 10, 2011, <http://newskaz.ru/economy/20110610/1571044.html>.

the project's first stage (90,000 cars annually) is planned for 2015; the second phase (30,000 cars) is expected to begin by 2017, and the investments into the new plant would total USD 514M.<sup>77</sup> An assembly line for VECTOR agricultural combines has been organised by Rostselmash in partnership with Kazservice, based on LLP Combine Plant Vector in Akmola province. Currently, local content of combine assembly in Kazakhstan does not exceed 23 %, but this will increase to 50 % when annual output reaches 500 combines.<sup>78</sup>

Collaboration in the field of *aerospace* is one of the most promising areas of Russia's cooperation with Kazakhstan that possesses the essential material, intellectual and financial resources. At the end of 2005, the Russian Khrunichev State Space Research and Industrial Center and the Kazakh Committee on Government Property and Privatization established JV Baiterek (Topol) in Astana. The Baiterek JV is developing a technical complex and launch facilities for a heavy Angara missile vehicle that is expected to enter the international market of commercial space services. Missiles will be supplied by the Russian party, while the project will be financed from the budgetary loan of about USD 200M provided by Kazakhstan. The first missile launch from the Baiterek complex is planned for 2015 with maximum launch frequency of twelve times a year.<sup>79</sup> Additionally, since November 2011, Russia and Kazakhstan jointly operate the second Kazakh communication satellite KazSat-2 which was placed into orbit by a Russian launch vehicle.

Another relevant aircraft industrial project is the assembly of Yak-58 light passenger aircraft and A-31 agricultural airplanes by the Kazakh-Russian company Yak Alakon in Almaty province since 2011. Total investment amounts to about USD 60M. In Karaganda province, the construction of an aviation plant for the assembly of Fermer agricultural airplanes by the Russian-Kazakh company KazAviaSpektr began in 2010. The project costs USD 65M and will be in operation until 2016.<sup>80</sup>

The development of cooperation in aircraft engineering between Russia and Uzbekistan has been less successful. In November 2007, the government of Uzbekistan and Russian United Aircraft Corporation (UAC) signed a memorandum on the integration of the Tashkent Chkalov Aviation Industrial Association (TAPOiCh) within UAC in exchange for 51 % of TAPOiCh shares and the launching of assembly of Il-114 short-haul passenger aircraft and Il-76 transport aircraft in Tashkent. In October 2010, the Uzbek government which controlled 76.6 % of TAPOiCh shareholdings, initiated bankruptcy proceedings in the company. The enterprise is expected to be re-designed for the manufacture of passenger cars by GM-Uzbekistan.<sup>81</sup>

Despite these initiatives, the proportion of Russian investments into high-tech projects in Kazakhstan and other CA countries is low, especially compared to other foreign investors. The only

<sup>77</sup> "V Kazakhstane v 2015 godu zapustyat proizvodstvo avtomobilei Lada", November 10, 2011, <http://www.newskaz.ru/economy/20111110/2108725.html>.

<sup>78</sup> "Rostsel'mash otkryl sborochnoe proizvodstvo v Kazahstane", July 29, 2010, [http://www.i-mash.ru/news/nov\\_otrasl/9701-rostselmash-otkryl-sborochnoe-proizvodstvo-v.html](http://www.i-mash.ru/news/nov_otrasl/9701-rostselmash-otkryl-sborochnoe-proizvodstvo-v.html).

<sup>79</sup> Heifets, *Rossiyskiy biznes...*, 182.

<sup>80</sup> "Sborku legkih vertoletov planiruetsya organizovat' v Astane v 2012 godu", December 20, 2010, <http://newskaz.ru/economy/20101220/997144.html>.

<sup>81</sup> "Uzbekskoe pravitel'stvo obankrotit proizvoditelya Il-76", October 13, 2010, <http://lenta.ru/news/2010/10/13/tapo/>.

sector where Russian companies hold a leading position is *mobile communications* and telecommunications. Several Russian mobile phone companies operate in Kazakhstan, where they are constructing third generation networks. These include VypelCom Ltd that owns a controlling interest (74.9 %) in KaR-Tel, and Eventis Telecom Holdings, a Cyprus offshore company with Russian roots, that owns 49 % of Eventis Telecom Kazakhstan. In Kyrgyzstan, JSC Sky Mobile (with trademarks Mobi and Bitel and about 1.5 million subscribers) is a part of VypelCom Ltd. group. In 2012, Eventis Telecom Holdings took over, upon court order, a 51 % interest in Megacom, the largest mobile operator in Kyrgyzstan.<sup>82</sup> Another Russian company, MegaFon, owns 75 % of shares of the joint Russian-Tajik JSC MegaFon-Tajikistan (formerly TT Mobile) with over one million subscribers in 2012.<sup>83</sup> VypelCom acquired a controlling interest (60 %) of the Tajik mobile operator Tacom for USD 12M. Similarly, in the Uzbek telecommunications sector, the leading positions are occupied by subsidiaries of Russian operators MTS and VypelCom.

Opportunities for cooperation in *agribusiness* are exploited poorly. The promising lines for cooperation include joint development of infrastructure for the food market (building storage facilities, wholesale markets and terminals), the reduction in the number of intermediaries in the course of products' movement from producers to consumers based on the system of regular interbourse tenders and other forms of electronic commerce, and a conclusion of direct contracts between the participants of a single distribution system of the agricultural market.<sup>84</sup>

The land-locked position of CA countries necessitates their cooperation in the area of *transport* to facilitate the development of their foreign trade and economic relations. Major areas of cooperation with Russia include the joint development of transport infrastructure and, in particular, the creation of international transport corridors based on state-of-the-art technologies and the creation of common transport space which has been hampered by conflicts of interests and limited financial capacities of participating countries.<sup>85</sup>

Overall, the investment activity of Russian business in Central Asia is characterized by insufficient investments into manufacturing and industries with a high value added. That strengthens the predominantly primary export specialization of CA countries, which is highly ineffective and runs contrary to long-term economic interests of both Russia and CA countries.

### 4.3. Problems in the development of investment cooperation

The degree of attractiveness of a national economy for foreign investors largely depends on the national environment for business development. The integral and individual characteristics of this environment are regularly assessed by several international organizations. The annual World Bank *Doing Business* reports rank economies based on an aggregate international rating calculated as an average of experts' assessments of specific indicators reflecting the ease of doing business in the country. CA countries do not rank high, but considerable

<sup>82</sup> "Piterskie svyazisty» podelili Kirgiziyu s synom svergnutogo prezidenta", February 28, 2012, <http://biz.cnews.ru/news/top/index.shtml?2012/02/28/479226>.

<sup>83</sup> "MegaFon v Tadzhiqistane otmetil millionnogo abonenta", January 18, 2012, <http://www.moscow.megafon.ru/publications/20120118-1346.html>.

<sup>84</sup> Kulik et al., *Ekonomicheskie interesy...*

<sup>85</sup> Ibid.

progress has been achieved lately by Kazakhstan and Kyrgyzstan due to several institutional reforms implemented, and a serious reverse movement was demonstrated by Russia, Tajikistan and Uzbekistan (see Table 5).

**Table 5. Ease of doing business in Russia and CA countries**

	Russia	Kazakhstan	Kyrgyzstan	Tajikistan	Uzbekistan	Afghanistan
Aggregate ease of doing business rank	120 (96)	47 (63)	70 (90)	147 (133)	166 (147)	160 (162)
Starting a business	111 (33)	57 (40)	17 (41)	70 (166)	96 (70)	30 (17)
Obtaining a construction permit	178 (163)	147 (119)	62 (143)	177 (85)	145 (138)	162 (...)
Protecting investors	111 (60)	10 (46)	13 (33)	65 (172)	133 (118)	183 (173)
Ease of paying taxes	105 (98)	13 (66)	162 (150)	168 (154)	157 (155)	63 (30)
Ease of getting credit	98 (159)	78 (48)	8 (65)	177 (143)	159 (159)	150 (174)
Trading across borders	160 (143)	176 (172)	171 (173)	177 (163)	183 (169)	179 (152)

*2011 ranking among 183 countries (2007 ranking among 181 countries)*

*Sources: World Bank (2006, 2012).*

Perhaps the most serious obstacle to cooperation between business structures of Russia and CA countries is a persistent and, in some cases, growing protectionism in international trade and investment. One of the instruments employed to restrain the expansion of Russian business in Central Asia is a deliberate overstatement of the market entry price that deters potential investors. This issue is of current concern, since several countries of the region are planning to privatize large government-owned assets that could be attractive for Russian business. Quite often Russian companies experience problems obtaining licenses and permits for their business activities. In some cases, Russian companies are driven out from projects they initiated, and regulatory bodies exert excessive pressure. Tenders won by Russian companies have been canceled, when local businesses, using administrative leverage, have resorted to corporate raids. Additionally, countries of the region have not yet shaped judicial systems independent from other branches of government, complicating the upholding of Russian firms' interests in arbitration courts. As a result, even large Russian investors do not feel sufficiently protected in CA countries. Entry into markets and normal commercial work are virtually impossible without corresponding government support.

In all fairness, CA companies encounter many of the same problems in Russia where administrative leverage and other non-economic factors are also prominent. Some criticisms of CA companies are based on the behavior of their Russian counterparts that do not always meet their commitments. This was the case during the crisis of 2008 – 2009, when several Russian investors faced serious financial problems. Additionally, large Russian companies are rightly perceived in the CA countries as a threat to national businesses in CA, as they are liable to monopolize the market and to lobby for their interests, as well as the political interests of Russia.<sup>86</sup>

Substantial non-economic costs characteristic of CA markets include the political ambitions of national elites, which frequently do not reflect economic realities. As these elites are most-

<sup>86</sup> Heifets, *Rossiyskiy biznes...*

ly motivated by present-day needs, even the slightest changes in a political situation result in the renunciation of earlier assumed obligations. This increases risks for business and fuels corruption. While some investors view corruption in host countries as an overhead cost, it presents a significant barrier to business development, especially during a financial crisis. The leaders of the less developed countries of the region also tend to overestimate their countries' investment potential due to a lack of reliable information, government favouritism and the absence of independent monitoring.<sup>87</sup>

Technical and economic factors negatively affecting the investment climate in CA countries include numerous complications with transboundary cargo crossing, such as a shortage of border crossing points, lengthy customs clearance procedures, the absence of unified requirements for production certification, and high transport tariffs. These cause a considerable price rise of products delivered and in some cases even make trade economically inefficient. Cooperation with CA business structures is hampered by intricate taxation mechanisms that persist in some countries (Uzbekistan, Turkmenistan), and rigid currency regulations that complicate profits repatriation for Russian companies. There are also difficulties making settlement payments and direct money transfers. Mechanisms for intergovernmental regulation of investment flows, and for investments promotion and protection are poorly developed. All these factors complicate the operations of Russian investors, resulting in unpredictable results of privatization and other investment transactions involving assets which are important for Russia.

At the same time, recent improvements in the investment climate in several CA countries, especially in Kazakhstan, have resulted in a growth of investments by Russian SMEs, especially in manufacturing industries, trade and services. While the number of Russian firms operating in Kazakhstan declined in 2009-2010, over 400 companies (primarily SMEs) registered and began operations during the 1<sup>st</sup> quarter of 2011, demonstrating a 7-8 % growth. According to the Russian Chamber of Trade and Commerce, this situation was a result of a more favorable taxation climate in Kazakhstan, compared to Russia. This does not yet mean a leveling-off of the business environment in the two countries of CU; that could only happen after the establishment of the Common Economic Space.<sup>88</sup>

## 5. Labour migration from Central Asia and workforce balance in Russia

### 5.1. Labour migration from Central Asia to Russia

Since the breakup of the USSR in 1991 to 2010, over two million, mainly Russian-speaking people, left CA countries seeking permanent residence in Russia. The proportion of indigenous CA peoples in this migration flow grew over the 2000s.<sup>89</sup> Official RF statistics approxi-

<sup>87</sup> E.V. Kozievskaia et al., eds., "Perspektivy` uchastiya rossiyskogo biznesa v sodeystvii mezhdunarodnomu razvitiyu v stranakh SNG (na primere Kirgizii i Tadzhikistana)", *Vestnik mezhdunarodnykh organizatsiy: Obrazovanie, nauka, novaia ekonomika*, no. 2 (2011): 101 – 112.

<sup>88</sup> "Kazakhstan otkryt dlia rossiyskogo biznesa - predstavitel` TPP RF", *Torgovo-promyshlennyye vedomosti*, no. 12 (2011), <http://www.kazakhstanlive.ru/news.php?ID=732>.

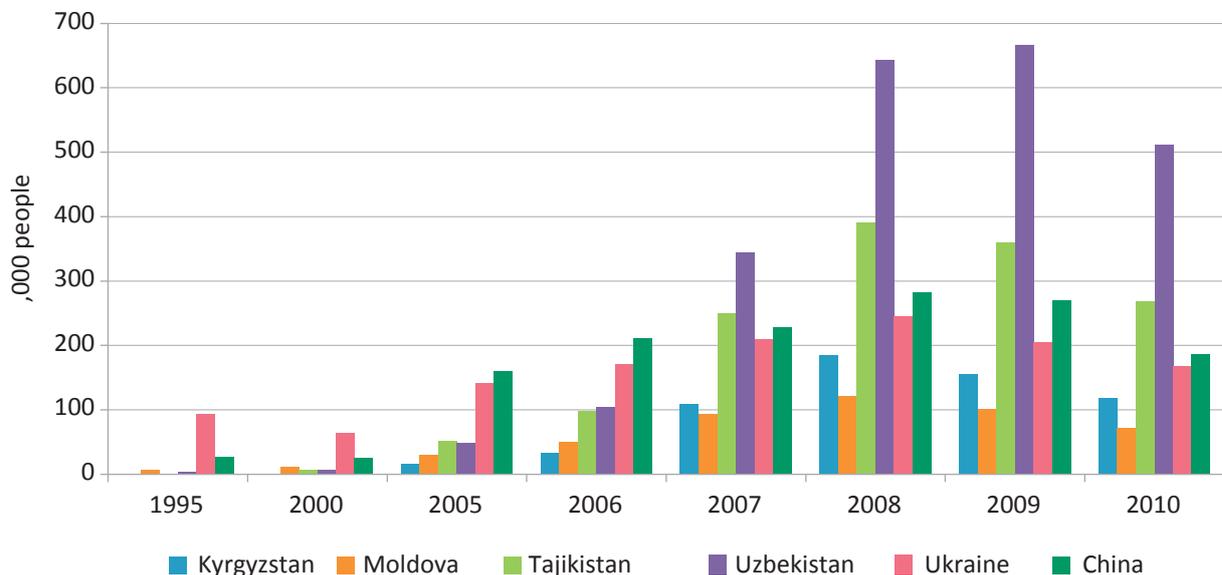
<sup>89</sup> M.B. Denisenko and N.V. Mkrtchian, "Migratsionnyi potencial Srednei Azii" (Working materials of the 7<sup>th</sup> Working Committee on preparation of "Strategy-2020", 2011), <http://strategy2020.rian.ru/load/366063112>.

mate 12.3 million legal immigrants at the end of the 2000s.<sup>90</sup> While tracking illegal migration in Russia is difficult, 5-8 million people are also estimated to have entered the country illegally. In post-crisis Russia, the proportion of immigrants (legal and illegal) in the total number of employed is estimated at about 8-10 %, which is close to levels in some European countries, such as Germany and Austria.<sup>91</sup>

Major factors causing migration flows from CA countries to Russia are differentials in per capita income and wages, as well as high unemployment and poverty in CA countries (see Table A4). The average wage in Tajikistan was just 10 % of the Russian average wage in late 2000s, and those in Kyrgyzstan and Uzbekistan were just slightly above 20 %. High population growth is also an important factor. In Kyrgyzstan, the population of active working age (15-60) increased by over 1 million from 1992-2008, while the number of employed increased by only 300,000. In Uzbekistan, an increase in working age population exceeded that of the number of employed by 3 million people.<sup>92</sup> Throughout the entire pre-crisis period, Kazakhstan was the closest to Russia in wage level, and also hosted a significant number of migrants from CA countries. From 2000 to 2008, despite all-round wage growth, regional differentials remained stable.<sup>93</sup>

Migration in the region is also fostered by a retention of a visa-free regime between CIS countries, comparative ease of border crossing, ease of employment, the existence of growing expat communities, mutual recognition of education certificates, and cultural and linguistic commonality.

**Figure 12. Gross inflow of foreign workforce into Russia, 1995-2010 (by major countries)**



Sources: Russian Federal Migration Service, Rosstat.

<sup>90</sup> World Bank, *Migration and Remittances Factbook 2011* (Washington DC: World Bank, November 2010).

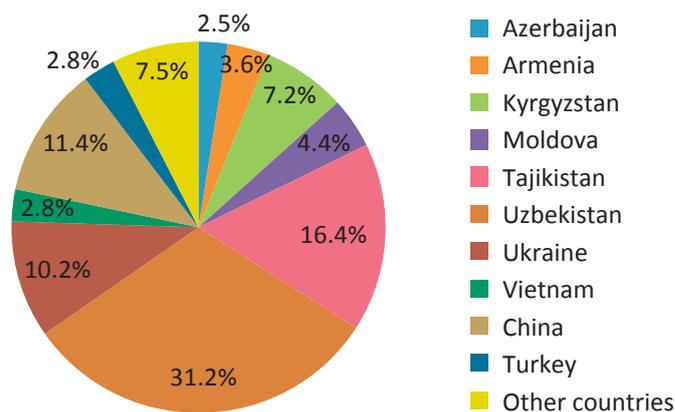
<sup>91</sup> V.A. Postavnin, N.I. Vlasova, I.G. Matveeva, "Analiz protsessov privilecheniya inostrannoi rabochei sily v Rossiyskuyu Federatsiyu" (Strategy 2020. Group 21. Development of economic and social integration in the post-Soviet space. Material for discussion, 2011), <http://2020strategy.ru/g21/documents/32580296.html>.

<sup>92</sup> Denisenko and Mkrtchian, "Migratsionnyi potencial Srednei Azii".

<sup>93</sup> Ibid, and M. Yu. Golovnin and A.E. Yakusheva, "Regional'nye efekty mirovogo ekonomicheskogo krizisa na prostranstve SNG: kanal denezhnykh perevodov migrantov", *Evraziyskaya ekonomicheskaya integratsiya*, no. 2 (May 2011).

The inflow of workforce to Russia from CA countries has been consistently growing throughout the entire pre-crisis period. The highest growth rates of migration were from Uzbekistan, Tajikistan and Kyrgyzstan (Figure 12). In 2005, these three countries accounted for 16.8 % of all migrants into Russia and for 34.3 % of those from CIS countries. These figures increased to 23.4 and 44 % in 2006, and to 41 and 61 % in 2007. By the end of 2010, citizens of these three countries accounted for 55 % of the total legal foreign workforce in Russia, and for 72 % of the labour force from CIS countries. According to the Russian Federal Migration Service, out of 6.3 million foreigners that arrived in Russia in 2009, 2 million were citizens of Uzbekistan, Tajikistan and Kyrgyzstan. As a result, the ethnic Asian component of the migrant labour force in RF has grown dramatically; the major suppliers of CA workers to Russia in 2010 were Uzbekistan (31 % of migrants), Tajikistan (16 %) and Kyrgyzstan (7 %) (see Figure 13). The proportion of Russia-oriented migrant workers is estimated at 85 % in Kyrgyzstan and almost 100 % in Tajikistan, and the majority of Uzbek migrants also aim to work in Russia. These account for 17 % of the economically active population in Kyrgyzstan, for almost 37 % in Tajikistan, and for 15 % of employed population in Uzbekistan.<sup>94</sup>

**Figure 13. Major providers of migrant labour to Russia in 2010**



Source: Rosstat.

## 5.2. Impact of migration on labour force balance

The retention of a positive migration balance is vital for maintaining Russia's population numbers at least at the present level. Russia is losing population due to a demographic crisis caused by natural population decline. In this context, labour migration simultaneously compensates for this natural decrease and fills in empty or newly-formed social and economic niches. In 2009, migration inflow covered Russian population loss due to mortality. For the first time during the post-Soviet period, Russia's population increased by 25,000 people; at the same time, the number of permits for obtaining Russian citizenship was 330,000.<sup>95</sup> On the contrary, in 2010, natural population decline was not compensated

<sup>94</sup> Denisenko and Mkrtchian, "Migratsionnyi potencial Srednei Azii", and Postavnin et al, "Analiz protsessov...".

<sup>95</sup> Golovnin and Yakusheva, "Regional'nye efekty...".

by migration gain, with population growth due to migration covering only 61.9 % of the natural decline.<sup>96</sup>

Labour migration is becoming an important component in balancing the supply and demand of labour in Russia. In addition to overall depopulation, Russia is also experiencing a decrease in population of working age, which declined by 973,000 people in 2009, and again by 769,000 people in 2010. According to a conservative forecast, the number of working age population could decline by 9.1 million or 10.4 %, by 2020, compared to the number in January, 2011.<sup>97</sup> Natural population decline cannot be compensated for by either demographic policies or by raising labor productivity and production modernization, so the importance of labour migration in maintaining labour supply in Russia is growing.

The population of working age (inclusive of migration inflow) is expected to decrease by 10.4 million people from 2011 to 2025. If migration inflow is excluded, this figure increases to 13.5 million. Migration from CA countries will not be able to compensate for even half of this decline, since the opportunities for compensatory inflow could dwindle due to a forecasted exhaustion of available labor supply in CA countries. The aggregate population increase (in the absence of migration) in Kyrgyzstan is projected to amount to 0.8 million for the same period, 1.6 million in Tajikistan, 4 million in Uzbekistan and 0.7 million in Turkmenistan.<sup>98</sup> Migrant labour is in demand at workplaces characterized by poor or heavy work conditions, seasonality and low wages, which are not attractive for the local population. According to the Russian Federal Migration Service, over 80 % of migrant labourers are consistently employed in five economic sectors: construction, wholesale and retail trade, agriculture, manufacturing, and transport and communications (see Table 6).

**Table 6. Distribution of foreign workers legally employed in Russia by major economic sectors, 2005-2010 (%)**

	2005	2006	2007	2008	2009	2010
Construction	38.7	40.8	40.2	42.0	39.4	36.3
Agriculture	4.8	7.2	6.5	6.6	7.9	9.1
Manufacturing industries	6.9	9.1	9.2	12.2	11.9	13.5
Wholesale and retail trade	30.5	26.7	19.2	17.0	18.4	16.6
Transport and communications	4.7	4.6	4.4	3.9	4.2	4.3
Other activities	14.4	11.6	20.5	18.4	18.2	20.3

Sources: Russian Federal Migration Service, Rosstat.

Several economic niches, such as construction and repair, housing and utility services, trade, and roadway maintenance are occupied by migrants due to their willingness to engage in informal activities at relatively lower wages. As a result, the percentage of local workers in

<sup>96</sup> Gaidar Institute for Economic Policy, *Rossiyskaya ekonomika v 2010 godu. Tendencii i perspektivy*, Issue 32 (Moscow: Gaidar Institute, 2011).

<sup>97</sup> Ibid.

<sup>98</sup> M.B. Denisenko, "Mezhdunarodnaya migratsiya v Rossii - osoznavaemaya neobhodimost" (Working materials of the 7<sup>th</sup> Working Committee on the preparation of "Strategy-2020", June 2, 2011), [http://strategy2020.rian.ru/g7\\_docs/20110602/366079666.html](http://strategy2020.rian.ru/g7_docs/20110602/366079666.html).

these jobs has been significantly reduced. Initially, migrants from CIS countries became entrenched in these spheres in Moscow, then in other cities over one million, and finally in other large cities. Currently, the employment sectors of local and migrant populations do not overlap, especially in Moscow. Additionally, a significant proportion of migrant labour is occupied in the informal economy as uncontrolled migrant flows create breeding grounds for shadow economic activities.<sup>99</sup>

A decline in demand for labour during the economic crisis and a commitment to prevent the growth of unemployment resulted in a twofold reduction in the total number of entry quotas issued to migrants in 2009 (from 3.9 to 1.95 million people).<sup>100</sup> New quotas, however, were used only for 82 % in 2009. In the course of the crisis, the number of officially registered migrants was reduced three times – from 13.5 million in 2008 to 4.5 million in 2009.<sup>101</sup>

During the crisis, a massive transfer of migrants from the legal sector of the economy to the shadow one occurred. From 2008 to mid-2010, an estimated 2 to 3 million migrants lost their jobs. The declining demand for labour in Russia and Kazakhstan narrowed employment opportunities for CA migrants. However, the situation in their home countries was even less favourable and did not encourage their return back home. CA governments initiated measures to fight unemployment (Tajikistan announced the creation of 180,000 new jobs), but in practice they resulted in latent dismissals.<sup>102</sup> Eventually, only about 20 % of migrant labourers from CA countries returned back home during the crisis, while the proportion of illegal migrants in Russia and Kazakhstan reached, by various estimates, 65 to 80 %.<sup>103</sup>

The crisis enhanced the orientation of Russian migration policy towards short-term labour migration, an orientation that runs contrary to Russia's strategic interests and impedes the effective substitution of the working-age population loss by migration human resources. It is also at variance with typical behavior patterns of migrant labourers to Russia; over 60 % spend the greater part of the year in Russia, and about one-third are seeking permanent residence.<sup>104</sup>

As Russia's own human resources are dwindling, and the economy grows and diversifies, the demand for diversely skilled labour is increasing. Despite forecasts of population growth in age groups likely to migrate (15 to 45 years old) in CA countries (4 million people from 2011-2030), the quality of their education, knowledge of Russian language, and their occupational training are degrading.<sup>105</sup> Almost half of migrants arriving in Russia lack professional education and can be employed without a special training in unskilled jobs only. Additionally, the cultural gap between them and the Russian population is growing, and their command of the Russian language is declining. According to the Russian Center of Migration Studies, in 2008, over 20 % of migrants believed that their knowledge of Russian was insufficient for living in Russia, and about the same proportion did not communicate in Russian at all.<sup>106</sup>

<sup>99</sup> Golovnin and Yakusheva, "Regional`nye efekty..."

<sup>100</sup> T. Smol'yakova, "Neohota k peremene mest," *Rossiiskaya gazeta* 19, February 1, 2011.

<sup>101</sup> E. Zubchenko, "Nezvanye gosti," *Novye Izvestiya*, October 14, 2009.

<sup>102</sup> T. Smol'yakova, "Neohota k peremene mest".

<sup>103</sup> Golovnin and Yakusheva, "Regional`nye efekty..."

<sup>104</sup> Postavnin et al., "Analiz protsessov privilecheniya..."

<sup>105</sup> Denisenko and Mkrtchian, "Migratsionnyi potentsial Srednei Azii".

<sup>106</sup> Ibid.

An interesting example of labour resource exchange is the cooperation between Russia and Kazakhstan that also hosts migrants from Tajikistan, Kyrgyzstan and Uzbekistan. The number of labour migrants from Kazakhstan in Russia is small and amounts to tens of thousands, and they are generally employed in near-border oblasts for short-term jobs. There is a reverse stream of migrant workers from Russia to Western Kazakhstan, mainly from the cities of the Volga region and Southern Urals, made up primarily of skilled specialists – oilmen, power engineers, and bank employees. As about a fourth (approximately 4 million) of Kazakhstan's population is ethnically Russian, the prospects for their potential employment in Russia are hopeful.<sup>107</sup>

### 5.3. Foreign labour engagement policy in Russia

The central issues that migration policy in Russia should deal with are an orientation towards long-term replenishment of Russian labour potential through external labour force inflow; selecting migrants with required qualifications; and establishing diverse channels to manage and support migrants' transfer to Russia, including permanent residence, work and education, supported by measures to aid their adaptation and integration.

In reality, current Russian migration policy is characterized by inconsistency, contradictions, and a lack of focus on long-term goals.<sup>108</sup> To-date, all efforts to develop a coherent Russian migration policy have failed. A draft concept was developed back in the early 2000s, but only a short document on migration processes regulation was adopted. In 2006, efforts were made to liberalize migration regulations for citizens of CIS countries. However, these were almost immediately blocked by amendments, subordinate legislation, bylaws and departmental regulations.

The lack of clear policy and relevant institutions, as well as poor information support inevitably lead to the development of an illegal sector – in migrant worker employment structure, in their border crossing, in employment processes, and in work and residence conditions in Russia. Russian employers, as a rule, benefit from these illegal processes since they preclude any official taxation and give them a solid competitive advantage. Migrants' poor awareness of their own rights, combined with the lack of legal and social guarantees, increases their vulnerability in the Russian labor market.

The practice of migrant worker quotas allocation in Russia (both overall and according to nationality) created a paradoxical situation, when a substantial number of migrants are living and working illegally in parallel with a large number of officially registered job vacancies. Efforts to move them out of the illegal sector by introducing the practice of licenses (a migrant employed in private sector – in domestic help, construction, repairs, etc. – has to acquire a

<sup>107</sup> "Migraciya iz Kazakhstana Rossii ne grozit", December 10, 2010, <http://news.mail.ru/inworld/kazakhstan/politics/4939582/>.

<sup>108</sup> *Obretenie buduschego: Strategiya 2012. Konspekt*. Institute of Contemporary Development – INSOR (Moscow: EKON-INFORM, 2011). [http://www.insor-russia.ru/files/Finding\\_of\\_the\\_Future%20.Summary.pdf](http://www.insor-russia.ru/files/Finding_of_the_Future%20.Summary.pdf).

relevant license) did not promote legalization since the cost of the license (about USD 32 monthly) is relatively high.

Currently, a new Concept of state migration policy is being discussed in Russia, based on the need to engage a new labor force for the country. Key components of this policy are to eliminate bureaucratic barriers; to cancel the quota allocation system that in practice induces illegal migration; to create more flexibility; and to ensure an extended inflow of skilled labor force to Russia.

In practice, the reality of large-scale labour migration and the development of the new migration policy face resistance based on a widespread xenophobia in Russia.<sup>109</sup> The inflow of culturally remote and less adaptive migrants highlights the need for the new migration policy to include a system for adaptation and integration of migrant workers. Currently, such a system is virtually absent, despite the creation of the Office of Integration Promotion under the Federal Migration Service in 2010.

Due to the lack of instruments to select migrant workers coming to Russia and open borders between Russia and the majority of CA countries, Russia hosts mostly low-skilled workers. Changes in the structure of workforce demand are reflected only in new entry quotas for migrants with specific professions. There are no limits on the entry of engineers, teachers and scholars into Russia, but the number of migrants from these professions is extremely small, and they usually come from “far abroad” rather than from CA countries.

Russian experts believe that Russia has already missed the opportunity to engage a significant number of educated and skilled workers represented by Russian compatriots, including those from CA countries, who chose to return to Russia after the breakup of the Soviet Union. Effectively prohibitive barriers to obtain Russian citizenship based on a 2002 law on citizenship, practically forced them to the West. The programme for assisting in voluntary relocation of compatriots of 2006 also proved to be an inefficient attempt to support an immigration inflow of Russophone population<sup>110</sup> to Russia. The programme was aimed at changing the professional and social structure of immigrants and promoting the resettlement to Russia of Russian-speaking populations that remained in the new independent states after the breakup of the USSR or subsequently emigrated to “far abroad”. Its aggregate impact, however, appeared to be twenty times lower than expected: 10,000 people instead of 200,000.<sup>111</sup> Still, the number of potential migrants from this pool is not large, and their mobility is low and continues to decline. While it is expected that about a half of the Russophone population remaining in CA countries will return to Russia during the next twenty years, this would not result in an adequate inflow

<sup>109</sup> L. Grafova, “Migranty nuzhny. I tochka. Nachalos’ obsuzhdenie proekta dolgozhdannoi Kontseptsii gosudarstvennoi migratsionnoi politiki,” *Rossiiskaya gazeta*, April 6, 2011, <http://www.rg.ru/2011/04/06/grafova.html>.

<sup>110</sup> By Russophone, or Russian-speaking population we mean people that use Russian language as a native one, or those whose culture is linked to Russian language, regardless of ethnic origin or territorial location.

<sup>111</sup> “Strategiya-2020: Novaya model’ rosta – novaya social’naya politika.” An interim report on the results of experts’ work on pressing issues of the socio-economic strategy for Russia for the period up to 2020. Moscow, August 2011, [http://www.hse.ru/data/2012/02/21/1263128561/doklad\\_08.pdf](http://www.hse.ru/data/2012/02/21/1263128561/doklad_08.pdf).

of educated and skilled migrants since the proportion of young people in this migration flow will already be small and that of pre-pension or retirement age will be large.

Despite large-scale migration flows from Central Asia, integration processes in the sphere of migration are developing slowly and it is unrealistic to speak of a common labor market and a common migration space so far. The major obstacles are inconsistencies and significant differences in migration policies and regulatory frameworks of Russia and donor countries. The countries involved still have no reliable information on real volume of migration flows and remittances between them, and considerable disparities exist in education systems. A serious obstacle is a reduced sphere of Russian language diffusion (see Section 6).

Priorities for Russia and CA countries in the formation of common migration policy include shaping of a common space in the sphere of professional education; the use of uniform programmes and coordinated procedures for professional (re)training and certification of migrant workers and increasing their awareness of employment opportunities. Cooperation in the protection of migrant workers' labour and social rights, including their health care and pension provision, are also a priority

The establishment of CU and CES have created new opportunities for developing a regulatory and legal framework for migration between member countries. The shaping of a CES regulatory environment for the three member states included an agreement on the legal status of migrant workers and members of their families that provided for free movement, job placement and employment of labor force between the three countries without special permits for employers or migrants. The agreement on cooperation in countermeasures against illegal labor migration from third countries protects the interests of the common labour market of the three member states. This example could provide a model for shaping the migration from Central Asian countries within the framework of regional integration processes.

Establishing a supranational structure of experts and practitioners could be instrumental in coordinating the development of a common migration space.<sup>112</sup> This structure could be based on the International Committee on Migration which includes representatives of administrative bodies, migration experts and civil society representatives from CIS countries. Another option is to establish such a structure based on the Migration and Remittance Peer-Assisted Learning Network (MIRPAL), an international network of practitioners and experts established in 2010 at the initiative of the World Bank. Its members include nine CIS countries, including Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. The major tasks of this network are to improve remittance and migration data collection in the CIS region; to enhance labour migration flow management; to increase the impact of migration and remittances on poverty reduction; and to assist in the development of a coordinated migration policy with a view to create a single migration space within CIS.

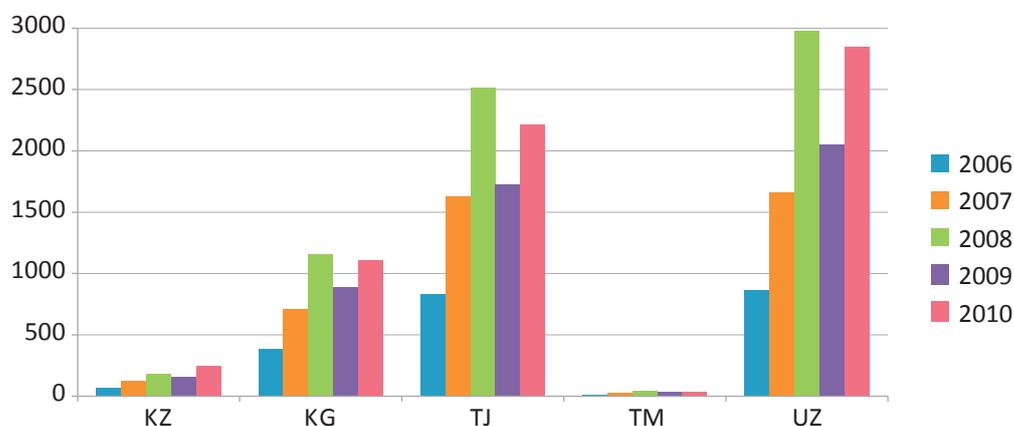
<sup>112</sup> N.I. Vlasova, "Integratsiya v sfere migratsii na prostranstve SNG." Strategy 2020. Documents of the Expert Group No. 7, June 2, 2011, [http://strategy2020.rian.ru/g21\\_docs/20110602/366079241.html](http://strategy2020.rian.ru/g21_docs/20110602/366079241.html).

#### 5.4. Remittances from Russia to CA countries

Currently, there is no reliable information on the volume of remittances by migrant workers in CIS countries. This complicates considerably the implementation of a sound migration policy both in Russia and recipient countries. A certain information on the amount of remittances to CA countries could be obtained from details on cross-border financial transfers made by non-resident individuals and on the flow of funds via money transfers<sup>113</sup>, available from balance of payments statistics published by the Russian Central Bank. These data, however, cannot provide a complete and accurate picture of migrant workers' remittances, since they do not include currency export by migrants themselves or illegal and semi-legal money transfers; still, these data allow the analysis of the remittances' regional structure. On the other hand, these data do include information on the transfer of profits from fruit and vegetable sales by small businesses, as well some other revenue transfers.

CA countries accounted for about half the total cross-border money transfers (USD 12.8 billion) made by individual persons (both residents and non-residents) from Russia in 2010 (Figure 14). Recently, remittances from Russia to CA region have been growing very rapidly. From 2006 to 2010, they almost doubled, compared to a 1.5 times growth for the total amount of remittances from Russia. The greatest proportion of remittances from Russia to Central Asia is channeled into three countries: Uzbekistan (40 %), Tajikistan (38 %) and Kyrgyzstan (18 %). Remittances to Uzbekistan have increased the most, primarily due to growing numbers of migrants from there to Russia.

**Figure 14. Remittances from Russia made through money transfer systems (USD million)**



Source: RF Central Bank

While the proportion of remittances to CA countries reduced to 48.9 % of total money transfers from Russia during the crisis in 2009, it increased again in 2010, reaching the pre-crisis level of 50.3 %. Changes in remittances appeared to be dependent on the recession in Russia. Against the restoration of production output in the real sector of the Russian economy, remittances of labor migrants remained below the pre-crisis level in 2010. This is particularly true

<sup>113</sup> Made via the following institutions: Anelik, BLIZKO, Coinstar Money Transfer, Contact, InterExpress, Migom, MoneyGram, PrivatMoney, UNISstream, Western Union, AsiaExpress, ALLUR, Blitz, Bystraya Pochta (Fast Mail), Golden Crown, LIDER, and Pochta Rossii (postal system of Russia).

of remittances to Tajikistan (88 % of the pre-crisis level), as migrants faced the dilemma of returning to jobs that they had before the crisis, and reduced salaries due to the crisis.

The significance of migrant workers' remittances for economic development in CA countries is difficult to overestimate. During the pre-crisis period, in 2007, they accounted for 48 % of GDP in Tajikistan and 27 % of GDP in Kyrgyzstan.<sup>114</sup> Estimates for Uzbekistan (no official statistics are made available) placed remittances at about 13 % of GDP in 2008.<sup>115</sup> During the crisis, the importance of remittances as a percentage of GDP in recipient countries somewhat declined. In Tajikistan, it dropped to 37 % in 2008-2009, as the volume of remittances in dollar terms was falling at a faster rate compared to GDP. Migrants' transfers from Russia started to grow again in 2010. Remittances to Uzbekistan increased by 22 % compared to 2009 (up to USD 1.4 billion); remittances to Tajikistan grew 29 %, reaching USD 2.4 billion; and those to Kyrgyzstan rose 25 %.<sup>116</sup> These transfers are instrumental for poverty reduction in recipient countries and contribute to decreasing differentials in economic development between CA countries, an essential factor in stabilizing the social situation in the CA region.

In Russia and Kazakhstan, substantial output in a number of sectors, such as construction, depends on migrant workers from CA countries. The development of integration processes in the sphere of migration is particularly important for Russia, that hosts about 80 % of migrant workers from Central Asia.<sup>117</sup>

## 6. The role of Russia in human capital development in Central Asia

Over the past 20 years, following the fall of the Soviet Union, the role of Russia as a leader in the shaping of the human capital in Central Asia has decreased dramatically. Of particular concern is the reduction of cultural and educational roles of Russia, associated with declining opportunities for CA student training at higher education institutions (HEI) in Russia, and for cultural and academic networking.

The role of Russian as the language of business communication in the region has diminished, in parallel with the increase of the use of national languages, associated with transfer of national documentation management to national languages and the reduction of Russophone population (e.g. in Uzbekistan), lessening radically the need for fluent command of Russian. According to sample surveys, in Kazakhstan 67 % of persons surveyed felt at home with the Russian language, in Kyrgyzstan this proportion was 38 %, in Tajikistan 35 %, and in

<sup>114</sup> According to data on balances of payments published by national statistical agencies and the CIS Intergovernmental Statistical Committee.

<sup>115</sup> International Crisis Group, "Central Asia: Migrants and the economic crisis," *Asia Report*, No. 183, January 5, 2010, <http://www.crisisgroup.org/en/regions/asia/central-asia/183-central-asia-migrants-and-the-economic-crisis.aspx>.

<sup>116</sup> Asian Development Bank, *Asian Development Outlook 2011: South-South Economic Links* (Manila: ADB, 2011).

<sup>117</sup> N.I. Vlasova, "Integratsiya v sfere migratsii na prostranstve SNG".

Uzbekistan just 27 % of those surveyed spoke fluent Russian.<sup>118</sup> For children and youth, opportunities to study in Russian have decreased, due to a general reduction in the number of Russian-language schools, varying by country. Russian-language training in tertiary education still remains dominant in Kazakhstan, where teaching in HEI is done mostly in Russian, and in Kyrgyzstan, where over 70 % of students are trained in Russian. In Tajikistan, higher education is only conducted in Russian in 26 HEIs, reaching 20 % of the total number of students. As a result, Russian linguistic and cultural influence has reduced, and a cultural and civilization gap between some CA countries and Russia has widened.

The role of Russia in the cultural development of the region is gradually being replaced by the influence of other countries, including China, USA, countries of the EU, and Iran and Turkey. The region's youth can now access opportunities to study abroad using well-known European programmes like TEMPUS or Erasmus Mundus and new programme such as the University of Central Asia's Central Asian Faculty Development Programme. In Kyrgyzstan and Kazakhstan, government programmes provide grants for talented students to study at European or US universities. Central Asian universities enter into bilateral agreements with European HEIs for scholarships, and western universities are establishing branches in some Central Asian countries. Returning students, especially those from Kazakhstan and Kyrgyzstan, complement the academic, industrial and management elites of their countries. At the same time, these graduates are often critical of cooperation with Russia and its capacity to assume a real role in the modernization, technological development, introduction of innovations, and development of political and social institutions in their countries.

The reduction of Russia's role as an educational nucleus for the young people of Central Asia could be attributed to the fact that, against the rapid growth of the export of education services all over the world, Russia's share of the market remains small and is even decreasing (according to OECD data, it fell from 3 % in 2004 to 2 % in 2007). Foreign students in Russia account for just 2 % of the total, while their respective numbers in UK stand at about 18 %, in Austria and France they are close to 15 %, and in Germany are about 13 %. Education in Russia is losing its elite reputation regarding even the leading HEIs due to a reduction in the quantity of high-quality HEIs and an insufficient number of specialties. These are compounded by excessive centralisation and bureaucratisation, the abuse of administrative power, the low autonomy of Russian HEIs and their poor physical infrastructure.<sup>119</sup>

Attempts to preserve a single educational space, or to form a new one, have been repeatedly undertaken within the CIS framework, but the treaties and agreements signed failed to attain the goal desired. Educational cooperation only attracted public attention in 2005, when a declaration and an agreement on humanitarian cooperation of the CIS countries

<sup>118</sup> "Russkii yazyk v novykh nezavisimyykh gosudarstvakh", Interim report on study results, Non-commercial partnership International Research Agency Eurasian Monitor and non-commercial fund Eurasian Heritage, October 2007, <http://www.ruskiymir.ru/export/sites/default/ruskiymir/ru/fund/docs/doklad.pdf>.

<sup>119</sup> B.I. Rakisheva and D.V. Poletaev, "Uchebnaya migratsiya iz Kazahstana v Rossiyu kak odin iz aspektov strategicheskogo sotrudnichestva v ramkakh razvitiya Tamojennogo soyuza," *Evrasiiskaya ekonomicheskaya integratsiya*, no. 3 (August 2011).

were signed. In 2006, seven CIS countries, including Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, established an Interstate Fund for Humanitarian Cooperation that supported several academic and educational projects. However, interaction between Russia and CA countries in the humanitarian sphere is estimated to be one of the most underperforming sectors of cooperation. The number of students from these countries studying in Russia is rather small and is far from being adequate to the potential of Russian tertiary and professional education. The RF Ministry of Education and Science is addressing educational migration issues exclusively within the framework of the government order. While sharing a positive view on academic mobility, Russia's support of this process is inadequate and insufficient.<sup>120</sup>

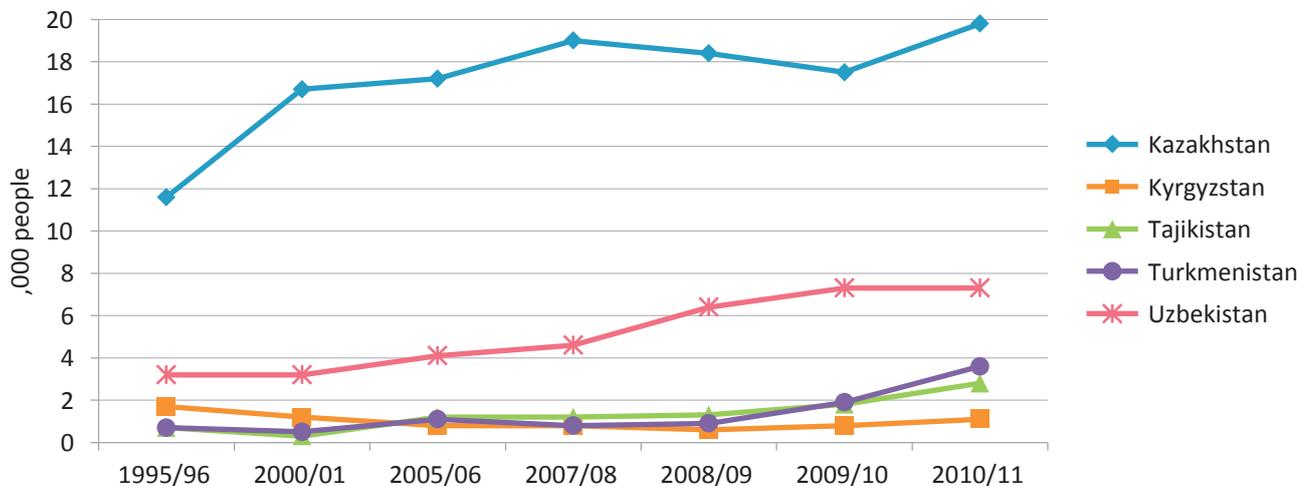
While the inflow of CA students to Russia has grown over the past few years, its overall volume remains modest, both against the intensity of CA student migration to third countries, and in view of the capacity of higher education in Russia. It is also notable, considering long-term traditional ties established during the Soviet period (Figure 15). Among principal barriers is the lack of financial support.<sup>121</sup> Taken generally low living standards in CA countries, only a limited proportion of CA households can afford a fee-based tertiary education in Russia. On average, every CA country is granted 100-180 reserved spots for tuition-free education at Russian HEIs annually. Kyrgyzstan is only allocated 50 to 70 reservations. The total quota for CA countries for the 2007/08 academic year, including all post-graduate and post-doctoral students, was 330 reservations; which is clearly insufficient, when you take into account the number of students applying to Russian HEIs, the total population of the region and the number of Russian-speaking citizens still oriented to Russian-language instruction. When applicants from CA countries apply to Russian HEIs in accordance with standard procedure based on the results of Russian unified state exams, they face problems stemming from differences in educational standards and the lack of prerequisite courses. It is not surprising that when grants or other educational opportunities become available, many young Central Asians prefer to get their education in Europe, USA or countries other than Russia. An increasing number of applicants regard education in these countries as being higher-quality and more likely to lead to better opportunities for consequent employment. Over 2,300 Tajik students are currently studying in Muslim countries, including 1,500 students in Pakistan and Saudi Arabia. In Kazakhstan, where students studying abroad are supported by the Bolashak government programme, an increasing number of applicants choose American and European universities over Russian HEIs; from April 2007 to June 2008, 46.6 % of fellowship recipients chose to go to the EU, 29 % chose to go to the USA, while Russia was chosen only by 9.5 %.<sup>122</sup>

<sup>120</sup> Ibid.

<sup>121</sup> M.V. Starchak, "Rossiiskoe obrazovanie na russkom yazyke kak faktor vliyaniya Rossii v Central'noi Azii: Chto proishodit i chto delat", 2008, <http://www.fondedin.ru/dok/starchak.pdf>.

<sup>122</sup> Ibid.

**Figure 15. Number of students from CA countries studying at Russian state-owned HEIs (at the beginning of the academic year)**



Source: Rosstat

The reluctance to seek higher education in Russia is also associated with the lack of mutual recognition of degree certificates. Agreements on mutual recognition of diplomas have only been signed by Russia with Kazakhstan and Kyrgyzstan, and only with a selected group of HEIs.<sup>123</sup>

As several Russian schools of sciences still hold leading positions in the world, the perception of Russian education as a high-quality one persists in CA countries, and Russia continues to remain an attractive platform for providing education for children from middle-class households in these countries. However, potential applicants from Kazakhstan identified a range of negative variables affecting their choice of country for tertiary education, including material and infrastructure shortcomings of the education process in Russia, everyday life in Russia, a high level of national xenophobia, an arrogant attitude on the part of law-enforcement officers, and a generally low level of public security. They also characterized the unfavorable climate for foreign students in Russia as having no measures for employment promotion for HEI graduates, no logical government policy towards educational migration and inadequate state participation in this process.<sup>124</sup>

When applicants from Kazakhstan (that make up the major part of the student flow from CA to Russia) select a place for higher education in Russia, they traditionally choose HEIs in the big cities of Moscow and St.Petersburg, or they choose cities that are relatively close to the Kazakhstan-Russian border (Novosibirsk, Omsk, Barnaul, Tomsk), or the university centers in the Volga region. Kazakh applicants are also interested in having Kazakh cultural centers where they are going to study, but a major factor affecting their choice is the state of relations between the local administration and the Kazakh expat community.<sup>125</sup>

<sup>123</sup> Ibid.

<sup>124</sup> Rakisheva and Poletaev, "Uchebnaya migraciya...".

<sup>125</sup> Ibid.

Educational migration is closely associated with the problem of professional training of migrant workers that is currently a pressing challenge in Russia. Enhanced cooperation in the field of education should be aligned with the changes in the paradigm of Russian immigration policy that aims to modify the structure of labor migration by engaging a more skilled labor force. The survey of potential HEI applicants in Kazakhstan demonstrated that the proportion of those who wish to study in Russia is markedly higher among the Russophone population of the country, and of those who have already chosen education in Russia, a significant percentage see this as a step towards returning to their historical homeland. Educational migration with consequent employment play an important role in consolidating the Kazakh community in Russia, and have contributed to stronger relations between Kazakh and Russian entrepreneurs. The Kazakh communities in Moscow and St.-Petersburg have been shaped by educational migration during the Soviet period.<sup>126</sup> Despite the obvious advantages of this form of skilled labour force engagement, initiatives to develop cooperation in the sphere of education oriented to the professional training of working migrants from CA countries are few, and minimal investments have been made in the re-training of workers at the local level, on-the-job training, and other training courses.

The policy of educational migration implemented currently in Russia is hardly capable to improve the quality of the available human capital, since it is not fully exploiting the research and educational potential of the country for training skilled CA specialists at Russian HEIs. As CA countries become progressively involved in international education networks, the trend towards the reduction of Russian influence and the strengthening of other, more potent, suppliers of educational services is more evident.

By weakening its influence in Central Asia, Russia is losing a potential capacity to affect the development of cooperation in the region by forfeiting opportunities to expand its influence through the advancement of Russian language, culture and values, and the accomplishments of Russian science. Graduates of Russian HEIs bring home a tolerant attitude towards Russia shaped at an interpersonal level. Without this, Russia will lose a direct link to future generations of CA managers, and the understanding of Russian realities by a new young elite in these countries will deteriorate.<sup>127</sup> In parallel with generational change, this will lead to a gradual degradation of cultural and historic ties with Russia and the erosion of contacts with Russian-speaking communities in CA countries; a resource that cannot be undervalued. The Russian population in Kazakhstan is estimated at over six million, in Kyrgyzstan, it is close to one million, and in Tajikistan it is 0.4 million.<sup>128</sup>

Russia could enhance its impact upon the development of human potential in the countries by strengthening its presence in the cultural and information realms of these countries. This would include support of Russian language as a means of inter-ethnic communication, the development of Russian-language population support programmes, and the expansion of cultural, academic and informational links. Russia's activity in this area is still modest, and untapped reserves for such cooperation are significant.

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<sup>126</sup> Ibid.

<sup>127</sup> Starchak, "Rossiiskoe obrazovanie...".

<sup>128</sup> B.A. Heifets, "Modernizatsionnaya orientatsiya sotrudnichestva Rossii so stranami EvrAzES i novye zadachi biznesa", *Evrasiiskaya ekonomicheskaya integratsiya*, no. 3 (August 2011).

## 7. Scope and mechanisms of development assistance to CA countries

### 7.1. Russia's participation in development assistance to CA countries

Over the past few years, Russia has noticeably increased its role as a donor to the World Bank's International Association of Development (USD 108 million in 2010) and as a source of official development aid (USD 472.3 million), of which 64 per cent were granted on a bilateral basis, and 36 per cent made available on a multilateral basis. The priority areas of Russian aid programs in 2010 included food safety and agriculture (USD 98.2 million), AIDS and infectious diseases prevention (over USD 80 million), as well as energy security, education and agriculture.<sup>129</sup>

A considerable part of Russian aid is channeled to development assistance to low-income countries of Central Asia. This, however, does not exclude the allocation of additional aid to these countries within the framework of CIS and EurAsEC. Close cooperation with UN specialized bodies, the World Bank and other international organisations could increase the allocation of aid resources to CA countries, and steps have been taken in this direction. In February, 2010 the RF Ministry of Finance and the World Bank signed an agreement on the joint programme for the support of Central Asian and East European countries in overcoming poverty and attaining sustainable social development.<sup>130</sup> Through this agreement, Russia can participate in the co-financing of specific important business projects, in fields such as education or healthcare, using budgetary resources allocated for international development assistance.

As could be seen from Table 7, Russian official development assistance to CA countries rendered on a bilateral basis is nowhere near the amount that could be expected based on the shared history of the countries and new impulses of regional integration. In 2009-2010, Russia was not among the top ten donors providing international assistance in any of the CA countries; a reality that reflects Russia's modest participation in international development aid programmes.

**Table 7. Official development assistance granted to CA countries (USD million, current prices)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Afghanistan	135.97	404.64	1287.73	1590.7	2303.1	2817.89	2955.78	3964.6	4865.08	6235.28
Kazakhstan	188.74	156.66	187.22	278.47	267	228.01	170.41	204.2	332.55	297.86
Kyrgyzstan	214.71	187.94	185.61	200.1	261.37	267.88	310.55	274.56	359.93	314.69
Tajikistan	123.5	165.29	168.32	148.09	248.29	251.48	241.21	222.08	290.64	408.89
Turkmenistan	31.48	72.61	40.52	28.56	37.1	30.37	24.71	28.48	18.13	39.88
Uzbekistan	185.75	153.88	189.25	194.55	245.82	169.7	149.21	169.76	187.25	190.3

Source: UNCTADStat.

*Official Development Assistance (ODA) includes grants or loans to countries on the OECD Development Assistance Committee List of Developing Countries which are undertaken:*

- *by the official sector;*
- *with promotion of economic development and welfare as the main objective;*
- *at concessional financial terms (if a loan has a grant element of at least 25 %).*

<sup>129</sup> In 2009, the amount of aid granted by Russia to the former Soviet republics was approximately 40 % higher than that granted in 2010, to soften the impact of the global financial and economic crisis (see C. Provost, "The rebirth of Russian foreign aid," *The Guardian*, May 25, 2011).

<sup>130</sup> Heifets, "Modernizaciionnaya orientaciya...".

Russia has provided bilateral emergency assistance to some CA countries in cases of emergency. At the beginning of 2012, Russia (along with other countries) provided emergency humanitarian aid to *Tajikistan* for overcoming the effects of abnormal weather conditions during the winter period. In January-February 2012, Tajikistan received over USD 6 million in humanitarian aid from 22 countries; of which just 18.1 % came from Russia, 15.1% came from the Netherlands, and 35.3%, the largest amount, came from Egypt.<sup>131</sup> In 2011, humanitarian aid to Tajikistan (over USD 86.3 million) was provided by 41 countries; of which only 6.3 % came from Russia, while the greatest proportion (70.6 %) was provided by the USA.<sup>132</sup>

The total amount of bilateral humanitarian aid provided by Russia to *Kyrgyzstan* after the events of April and June 2010, is estimated at USD 25 million. This includes assistance to citizens of Kyrgyzstan temporarily displaced to Uzbekistan and the delivery of 20,000 tons of fuel oil and 1.5 tons of winter wheat seeds. An additional USD 8 million of Russian aid was channeled to Kyrgyzstan through international organizations: USD 2 million was delivered through the World Food Programme (WFP) for food aid (total WFP aid to Kyrgyzstan was USD 6 million in 2010); USD 1 million through UNDP for recovery measures in the south of the country; USD 1 million through WHO for assistance in health service provision; USD 1 million through UNICEF for the assistance in water supply, sanitary services and education system support; and USD 3 million through the International Civil Defense Organization (ICDO) for technical assistance to fire-fighting and salvage units of the Kyrgyzstan Ministry of Emergency Situations and for assistance to injured persons. Russia also provided, within its 2010 annual voluntary contribution to WFP, USD 5 million and two grants of USD 20 million and 10 million each to Kyrgyzstan in 2010. As an additional measure to support the economy of Kyrgyzstan, customs duties on petroleum products exported by Russia to Kyrgyzstan were cancelled in February, 2011.<sup>133</sup>

Despite these contributions, compared to total international aid channeled to Kyrgyzstan during this period, amounts provided by Russia are not large. International financial organisations allocated USD 1.1 billion to Kyrgyzstan within 30 months for the revival of the economy, as well as for restoration of destroyed buildings in the south of the country. Out of this amount, USD 60 million was granted in 2010 as emergency aid.<sup>134</sup> The EU provided 118 million Euro (about USD 150M) in 2010-2013 due to the crisis in

<sup>131</sup> "Medvedev poruchil srochno okazat' gumanitarnuyu pomoshch' Tadzhikistanu", March 30, 2012. <http://www.rosbalt.ru/main/2012/03/30/963825.html>.

<sup>132</sup> L. Mahmadbekova, "41 gosudarstvo mira okazalo gumanitarnuyu pomoshch' Tadzhikistanu", January 17, 2012, <http://khovartj/rus/society/31374-41-gosudarstvo-mira-okazalo-gumanitarnuyu-pomoshch-tadzhikistanu.html>.

<sup>133</sup> RF Embassy in Kyrgyzstan, "Gumanitarnaya pomoshch' Kirgizii", n.d., <http://www.kyrgyz.mid.ru/gum.html>, accessed April 3, 2012; and "OON vydela na prodovol'stvennuyu pomoshch' Kirgizii \$6 mln v etom godu", December 23, 2010, <http://ria.ru/world/20101223/312408367.html>.

<sup>134</sup> "Mezhdunarodnye donory reshili vydelit' Kirgizii \$1,1 mlrd", July 27, 2010, <http://ria.ru/world/20100727/258965652.html> 27/07/2010,

the country, and the European Commission allocated 12 million Euro (about USD 15M) for maintaining social stability and the restoration of the constitutional order.<sup>135</sup>

Due to historical reasons and security issues, Russia's aid to *Afghanistan* is approached somewhat differently. From the beginning of the 1990s, Russia co-operated with the secular authorities of Afghanistan. After the withdrawal of Soviet troops from the country, the USSR, and later Russia, supplied weapons and ammunition to Northern Alliance to counteract Muslim extremists. Russia's non-repayable transfers of arms and ammunition contributed to the evolution of the country's police and armed forces. The RF also assists Western countries in delivering cargo for international security forces in Afghanistan, including providing territory for the transit of military cargo. According to Special representative of the RF President on Afghanistan Zamir Kabulov, Russian non-repayable military and technical support to Afghanistan only in 2002-2005 amounted to USD 200 million.<sup>136</sup>

Afghanistan also regularly receives humanitarian aid from Russia. Over the last ten years, Russia has delivered equipment and foodstuffs worth about USD 50 million. In 2009-2010, Russia delivered about 30,000 tons of wheat flour on a non-repayable basis, and in December 2009, 50 KAMAZ trucks and two fire trucks were supplied as part of the Russian contribution to WFP.<sup>137</sup> Additionally, in 2010, Russia wrote off USD 11.6 billion of old Afghan debts to the USSR.

Aid towards the economic recovery of Afghanistan is being discussed within the framework of the Russian-Afghani Intergovernmental Commission on Trade and Economic Cooperation. The March 2012 Commission session in Moscow discussed the participation of Russian business agents in seven projects carried out back in the 1980s by the Soviet engineers and workers, including restoration of the second phase of HPS in Sorabi district of the Kabul province; Polytechnical university (the former Kabul Polytechnical institute); house-building factory; and the establishment of a transportation company in Kabul. Afghanistan intends to restore, with Russian assistance, the power supply in the city of Mazari-Sharif, the cement works in Dzhabal us-Siradzh district of Parvan province, and a tunnel at the Salang mountain pass that connects the northern provinces of Afghanistan with Kabul.<sup>138</sup> Until recently, Russia had to finance the majority of its projects in Afghanistan through the United States Agency for International Development (USAID).

## 7.2. Resource support of CA countries in initiating integration processes

In a situation when several CA countries, such as Kyrgyzstan and Tajikistan, are facing serious economic and social challenges, their participation in integration projects is a convenient

<sup>135</sup> "Evrosoyuz vydelit Kirgizii 118 mln evro v 2010-2013 godah", July 27, 2010. <http://ria.ru/world/20100727/259053997.html> 27/07/2010.

<sup>136</sup> Yu. Paniev, NATO prosit Moskvu pomoch Afganistanu", *Nezavisimaya gazeta*, May 23, 2012.

<sup>137</sup> "Lavrov: Rossiya spisala Afganistanu bolee \$11 mlrd gosdolga", December 5, 2011, <http://www.bfm.ru/news/2011/12/05/lavrov-rossija-spisala-afganistanu-bolee-11-mlrd-gosdolga.html>.

<sup>138</sup> "Afganistan prosit Rossiyu pomoch' vosstanovit' ekonomiku", March 1, 2012, <http://www.vestifinance.ru/articles/8215>.

way to obtain external assistance, credit and resource support. This participation becomes a sort of barter transaction; their entry into the project in exchange for their involvement in the system of various grants and preferences. Multi-level and multi-speed integration offers many opportunities for countries participating in integration processes to access certain advantages in the course of bilateral talks with Russia. The result of such practices objectively devaluates integration initiatives.<sup>139</sup>

For Russia, opportunities to shape integration groupings under its own guidance are based on the use of its financial and energy resources, as well as on the capacity of its vast home market. As a result, according to experts' forecasts, the role of the donation component in Russian integration initiatives will be growing. The readiness of Russia, as a basic initiator of integration, to incur heavy expenditures on granting considerable economic concessions and preferences makes the price of integration a serious political problem. Russian experts believe that the political will of the Russian leadership to establish a CU-CES integration grouping creates a perfect environment for Russian partners to obtain economic concessions from RF. The construction of an integrated CU-CES on the basis of grants and concessions serves to replace the lack of Russia's own attractive project and to block centrifugal processes in the region.<sup>140</sup>

On the whole, the financial assistance of Russia has never been crucial for CIS countries since, as a rule, it has not been used efficiently. After receiving assistance, CIS governments did not respond with adequate systemic measures to modernise their economies and establish internal mechanisms to support macroeconomic stability. Russia also quite often lacked the institutions and mechanisms to exercise state financial support of export, investments and technical assistance to foster the economic development of partner countries, which has reduced the effectiveness of economic aid. Government loans were granted either on the basis of intergovernmental agreements for the maintenance of macroeconomic stability, for emergency response or support of large projects, or were transferred indirectly through Russian contributions to international financial organizations, where the identity of the donor, considering Russia's modest influence there, was lost.<sup>141</sup>

The present state of integration processes in Central Asia, combined with the effects of the economic crisis in Russia, have seriously limited the financial resources available for foreign aid, suggesting the need for changes in the mechanisms of financial assistance to these countries. In building such mechanisms, Russia needs to take into account the new realities of the integration processes, including the role of other centers of economic power that are attractive to countries in the region.

During the crisis, several multilateral international financial institutions increased their presence in Central Asia, proposing various packages of financial aid and credit support. At the end of 2009, the IMF granted USD 0.1 billion each in assistance to Tajikistan and Kyrgyzstan within the framework of anti-crisis financial packages. Experts believe that Russia simply cannot offer its partners, including CA countries, substantial aid packages, moreover

<sup>139</sup> A. Suzdaltsev, "Ocenka i prognoz razvitiya...".

<sup>140</sup> Ibid.

<sup>141</sup> Kulik et al., *Ekonomicheskie interesy...*

under the same preferential terms as China, the EU or the major Islamic nations do.<sup>142</sup> During the crisis, Russia's ability to maintain its interests in the region weakened even more. Still, to mitigate the negative effects of the world crisis, Russia extended a concessional loan for USD 300 million to Kyrgyzstan in 2009 to support the country's budget<sup>143</sup> and financial assistance of USD 150 million. Additionally, an attempt has been made to settle Kyrgyzstan state debt payments to Russia. It was suggested that the debt would be partly repaid by asset holdings, and the remaining part would be written off. Besides, an agreement on building the Kambarata-1 hydropower station and on raising USD 1.7 billion of Russian investments for this project has been signed.<sup>144</sup> However, the debt problem remains unresolved, and the investment project has not yet begun.

### 7.3. Reformatting mechanisms of financial and technical assistance in the region

The increased influence of multilateral international financial institutions in Central Asia, and the superior financial capabilities of other actors in the region have led Russia to reformat its financial and technical assistance mechanisms, from a bilateral to a regional approach. To stimulate integration in the region, which includes qualitatively different national economies, collective financial institutions are most appropriate to stabilize and consolidate the common economic environment in Central Asia. To implement joint anti-recession measures, the Eurasian Development Bank (EADB) was founded in 2009 with registered capital over USD 1.5 billion (the RF share is USD 1 billion). In addition, the EurAsEC Anti-Crisis Fund was organised with Russia, Kazakhstan, Belarus, Armenia, Tajikistan and Kyrgyzstan as its shareholders and a planned fund of USD 10 billion (of which 7.5 billion is the RF share).<sup>145</sup> The Fund is intended, *inter alia*, to support low income countries who are participants in the Fund and to allocate resources under terms and criteria, comparable to the granting of official international development assistance. Fund resources management is exercised by the Fund Council comprised of Ministers of Finance of participating countries and the EADB representative.

The EADB is authorized to finance intergovernmental projects with the use of the Fund resources. In August 2010, the first financial stabilization loan of USD 70 million was granted to Tajikistan to maintain budgetary financing of social sectors (education, public health services, social protection) at the pre-crisis level, and to support public finance and civil service reforms which are the integral parts of Tajikistan Anti-Crisis programme. Another twelve projects, totaling USD 2 billion, are currently under consideration.<sup>146</sup>

A new federal body, the Russian Agency for International Development (RAID), was established in January, 2012 to streamline bilateral development assistance granted by Russia. The agency reports to the Ministry of Finance and will develop, implement and co-ordinate development assistance projects, including financing supplies of industrial equipment, con-

<sup>142</sup> Ibid.

<sup>143</sup> At 0.75 % annual interest rate, for a term of 40 years with a grace period of seven years.

<sup>144</sup> Kulik et al., *Ekonomicheskie interesy...*

<sup>145</sup> In 2010, the Fund resources totaled USD 8.5 billion.

<sup>146</sup> "Antikrizisnyi fond EvrAzES," *Kommersant*, February 10, 2012, <http://kommersant.ru/doc/1869625>.

struction of manufacturing facilities, personnel training, and monitoring, evaluation and control of foreign aid programmes. One of the primary RAID goals is to establish a link between Russian companies and international assistance projects financed by the RF to bind the economies of recipient countries to Russian goods, technologies, services and components.<sup>147</sup>

## 8. Russian economic strategy in Central Asia

### 8.1. Strategies of integration in Central Asia

The establishment of a full-fledged FTZ within CIS and the formation of CU, CES, and by 2015, the Eurasian Economic Union (EAEU), brings the economic integration of the current and possible future member countries to a qualitatively new level. This level suggests the elimination of existing limitations of mutual access to national markets of member countries, the liberalization of exchange rates and financial policies, and the implementation of coordinated macroeconomic, tax, monetary, trade, customs and tariff policies.

The Russian concept of integration combines, by design, a post-Soviet vector of integration with Western and Eastern vectors. In his program article, V. Putin draws a roadmap, according to which the EAEU (created on the basis of CU) becomes an effective transcontinental link promoting development of a continental economic integration "from Lisbon to Vladivostok" and "from the Atlantic to Pacific Ocean."<sup>148</sup> The emerging CU-CES system is characterized by a certain rigidity and is based on the EU experience. It is worth noting that within the CES concept, European and post-Soviet integration models are not regarded as mutually exclusive; a significant degree of EU institutional transmission (for example, standards' convergence) is envisaged as beneficial to cooperation between the countries of the post-Soviet territory.<sup>149</sup> The CU and CES were established within the rigid schedule, aimed at solving problems arising between partners in the project (Russia, Kazakhstan, Belarus) in the shortest time possible. The accelerated progression of the CU- CES creates the risk of imbalances between the regulatory bases of newly organised integration projects, and those of other countries of the region. Even at the previous level of integration, in EurAsEC, integration processes in various spheres proceeded at different speeds. This is one of the reasons why the formation of FTZ is not complete, and the current regime is based in some cases on bilateral agreements which are not always implemented in full.<sup>150</sup> The processes of integration in the Eurasian space are further complicated by the fact that many of its countries have a low level of development.

Russian positions in the region can be further strengthened by its participation in large tripartite projects with the participation of CA countries and third interested parties in the

<sup>147</sup> "Moscow Crafting its own International Aid Agency," *The Moscow Times*, August 29, 2011.

<sup>148</sup> V.V. Putin, "Novyi integracionnyi proekt dlya Evrazii - budushee, kotoroe rojdaetsya segodnya", *Izvestiya*, October 3, 2011.

<sup>149</sup> S. Chernyshev, "Na puti k edinoi Evrazii". *Rossiia v global'noi politike* 3 (2010): 36-47, <http://www.globalaffairs.ru/number/Na-puti-k-edinoi-Evrazii-14872>.

<sup>150</sup> N. Yu. Kaveshnikov, "Razvitie institucional'noi struktury Evraziiskogo ekonomicheskogo soobshchestva," *Evrasiiskaya ekonomicheskaya integraciya*, no. 2 (May 2011).

spheres of energy, transport, general infrastructure, environmental protection in border areas, etc. However, to date, there are no plans for such initiatives.

The potential for cooperation could be realized through framework agreements signed between Russia (or the Customs Union) and leading regional organisations or specific countries within the framework of existing regional structures.

## **8.2. Labour migration strategy**

New Russian migration policy until 2025 is currently under development (see Section 5). The strategy proclaims, as a political declaration, the formation of a common labour market and of a common migration space within CES.

In practice, despite a considerable increase in migration flows, the integration processes in this sphere are still far from being completed. According to the results of the Strategy-2020 expert group,<sup>151</sup> current RF migration legislation is inadequate to the practical requirements of economic and demographic development, the interests of employers and Russian society as a whole. It is restrictive and is not aimed at engaging skilled migrant labour. The legislation is oriented towards engaging only temporary foreign workers. The concept of «immigrant» has not yet been thoroughly defined and permanent migration programmes are scarce, except for the poorly designed programme of assistance for the resettlement of compatriots. The procedures for obtaining temporary or permanent residence permits are complicated, and existing legislation does not provide for the development and implementation of immigration programmes for different categories of migrants.<sup>152</sup>

The system of engagement of temporary migrant workers is inefficient, despite large inflows of these workers. The system does not differentiate between foreign workers according to their terms of residence, and working contracts for all foreigners are limited to one year. There are no special programmes for seasonal migration. The system of quotas allocation does not take into account the requirements of the Russian economy in foreign labour and excludes the employer from the process of worker selection, serving instead as an additional bureaucratic procedure dividing migrants and employers.

Existing legislative restrictions for employment during the training period and afterwards reduce the attractiveness of education in Russia for foreign students. In Russia, there are no mechanisms for the selection of migrants with specific demographic, social, cultural and economic characteristics, or for persons with a high potential for adaptation and integration into Russian society.

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<sup>151</sup> "Strategiya-2020: Novaya model' rosta – novaya social'naya politika", An interim expert report on pressing issues of the socio-economic strategy for Russia for the period up to 2020, Moscow, August, 2011, [http://www.hse.ru/data/2012/02/21/1263128561/doklad\\_08.pdf](http://www.hse.ru/data/2012/02/21/1263128561/doklad_08.pdf).

<sup>152</sup> Which can include relatives, economic migrants, including highly skilled workers, investors, businessmen, self-employed workers and refugees.

Since all migrants are regarded as temporary, integration programs are absent, and in government or public debates, the necessity of pre-migration training is often mentioned. This could include vocational education, training in Russian language, legislation, history and culture that migrants should undergo at home and that should be coordinated with Russian labour market needs. In practice, however, coordination between Russian agencies, business structures and non-governmental organisations and their counterparts in labour donor countries is minimal.

New dimensions of migration policy should be aimed, first of all, at raising the efficiency of mechanisms regulating migration. The Strategy 2020 team suggests opening new migration channels, implementing a variety of systems for migrants selection, improving the regulatory and institutional environment for migration, and shaping of a new public image of migration and new approaches to the management of migration flows.

A radical change required in Russian migration policy is to shift its emphasis to support long-term or permanent immigration of highly skilled personnel, including professionals required in the Russian labour market, investors, businessmen, students, etc. Family migration and reunions should become a new priority of migration policy in Russia. Engaging various categories of permanent migrant workers requires the elaboration of special immigration programmes that would allow migrants to obtain the resident status essential for their integration into Russian society. These shifts in national migration policy would require structuring a special system of legal statuses for foreign citizens with an emphasis on resident status and the introduction of special legal status for long-term temporary migrants granted without regard to quotas. Increasing the attractiveness of Russia for foreign migrants also requires improvements in Russian legislation, including measures to enhance the social protection of migrants.

### **8.3. FDI attraction strategy, large investment projects with Russian participation**

Despite the increased attractiveness of Central Asia for foreign investments, the general quality of the investment climate and institutions in the majority of CA countries remains low (see Table 5); a fact that restrains cooperation in the investment sphere. When explaining low investment activity in the CA countries, Russian investors often refer to the realities of state protectionism and lack of cooperation from national business structures aiming at keeping control over assets to ensure rent seeking (see Section 4.3 for more detail). The investors are building their expectations on strengthened state support for investments and anticipated liberalization of investment flows. These will be promoted, along with the existing agreement on the encouragement and mutual protection of investments in EurAsEC member states of December, 2008, by the shaping of the CES regulatory framework for investments and entrepreneurial activity.<sup>153</sup>

The RF investment strategy in Central Asia is guided mainly by decisions made at the state level. Participation of SMEs is limited, which in turn limits investment potential. Coopera-

<sup>153</sup> Kulik et al., *Ekonomicheskie interesy...*

tion between Russia and other EurAsEC countries is developing according to special rules in which personal arrangements and relations between heads of states are decisive factors. These arrangements are usually dictated by special interest lobbyists close to power structures (whose approval is crucial for any serious transaction) rather than by the economic and political interests of the states.<sup>154</sup>

These realities suggest a significant political component in the selection of projects and avenues for investment cooperation, and, hence, their inadequate analysis from the viewpoint of strategy of economic interaction between participating countries. Due to the focus of CA countries (Kazakhstan, Turkmenistan, Uzbekistan) on energy and raw materials exports, combined with a low degree of raw materials and hydrocarbons processing, such a character of investment cooperation between CA countries and Russia cannot at present radically intensify regional economic integration. Many observers and experts repeatedly called attention to this aspect of the problem.<sup>155</sup>

The major factors that define the character of the RF investment strategy in the CA countries include:

- Lack of coordination between various RF agencies that affect the consistency of government policies with respect to CIS countries as a whole, and CA countries in particular;
- Selective, unsystematic and irregular Russian government support to the presence and operations of Russian companies in Central Asia;
- Inconsistency and unpredictability of public authorities' activities in CA countries, stemming from their so-called "multi-vector" foreign policy orientation and resulting in a breach of agreements reached;
- Inconsistency of Russian business behavior (today, interest in the region is high, tomorrow it disappears), and occasionally a neocolonial approach to CA countries.<sup>156</sup>

Under such conditions, it is hardly possible to speak about the participation of Russian companies in long-term business projects oriented at continuing cooperation with Central Asia.

The economic crisis amply demonstrated that the time has come to develop a comprehensive RF investment strategy in Central Asia, which includes defining key, strategically important assets for the functioning of Russian industries and companies, as well as tactics, mechanisms and instruments for mutually advantageous cooperation in the management of these assets. This is moreover important for the planning of effective value chains headed by Russian companies, as well as for stimulating integration processes based on industrial, technological and marketing cooperation.<sup>157</sup>

<sup>154</sup> Heifets, "Modernizacionnaya orientaciya...".

<sup>155</sup> Paramonov and Stokov, "Rossiia - Central`naia Aziia...".

<sup>156</sup> Kozievskaja et al., "Perspektivy uchastiya...".

<sup>157</sup> Kulik et al., *Ekonomicheskie interesy...*

## 9. Impact of cooperation with CA countries on Russian economic development

While the role of the Russian market is of primary importance for CA countries, for Russia, the importance of cooperation with CA countries is not so evident. This is *inter alia* supported by the fact that the qualitative and quantitative characteristics of mutual trade achieved during the Soviet period have not yet been restored. Still, Russia is highly interested in operational forms of cooperation and in potential avenues of cooperation which could contribute to the formation of complementary economic complexes.

### 9.1. Advantages of integration: Russia's view

When initiating integration processes in the CA region, such as signing the FTZ Agreement, establishing the CU, harmonising regulatory regimes within the EurAsEC, and moving towards the CES, Russia is pursuing both political (strengthening the country's international status as a center of the regional integration block) and economic goals, including the following:

- Mastering the vast, barrier-free markets of Central Asia with almost 62 million consumers (excluding Afghanistan) or 96 million (including the latter), the importance of which in Russian trade would be growing due mainly to mutual deliveries of manufactured goods, including machinery and equipment, rather than to energy resources and metals;
- Creating a favourable environment for assets acquisition by Russian investors primarily in export-oriented and knowledge-intensive industries, and joint development of a regional market for funding investment projects;
- Implementing large-scale mutual infrastructure projects in energy transit and transport fields, including the prospective development of up-to-date transportation routes in the East-West and North-South directions, as well as in industry and agribusiness;
- Coordinating and, over the longer term, implementing a unified policy in labour market regulation, including social assistance to migrant workers; and
- Creating a regional financial centre in Russia and a centre of commodity exchange with payments in a single currency.

The CU and CES provide Russian investors with access to Kazakhstani resources, and increase the demand for Russia's transit transport services in the latitudinal direction. In parallel, the competition between Kazakhstan and Russian enterprises is bound to slacken, and Russia will get the chance to coordinate its efforts with Kazakhstan on the world energy market.<sup>158</sup> At the same time, the integration projects initiated by Russia so far represent long-term goals. Currently, Russian partners in integration projects are especially interested in new opportunities to obtain cheap energy resources, solve their transit problems, and in creating free and unlimited access to the Russian market. The objectives of a common market and an economic and currency union with a common macroeconomic and exchange policy (what would result in a certain limitation of national sovereignty in favor of supranational bodies in the future integration grouping), remain, in reality, future strategic targets.

<sup>158</sup> A. Suzdaltsev, "Ocenka i prognoz razvitiya...".

A pressing issue in the structure of the functioning CU, and the evolving CES, is the low proportion of mutual trade in equipment and technology; the existing integration projects remain concentrated on exports of raw materials and energy resources to external markets (see Section 2). Kazakhstan is more oriented towards the EU and China rather than Russia for its imports of machinery and equipment. Hence the prospects of integration are linked to the rate of modernisation of the Russian economy that would allow Russian partners in CA to implement integration projects contributing to modernization of their economies.

The new integration regimes do not always foster penetration of Russian corporations into Central Asia. In many cases, the existence of a formal institutional environment is not regarded as an advantage by Russian business structures, which are used to steadily operate against the background of poorly formalized and undefined rules.<sup>159</sup> For Russian businessmen, it is often more convenient to deal with bureaucratic structures within CA countries directly, avoiding the integration bodies. The emerging regime will likely appear (at least in a middle-term perspective) contradictory and complicated, which could hinder the development of cooperation.

## **9.2. Cooperation in the sphere of infrastructure and transport**

With its developed pipeline system, and being actively engaged in the new infrastructure projects, Russia is interested in expanding its own transit potential and taking advantage of its location to provide oil and gas transit from CA countries to the world market (primarily Europe). On the other hand, Russia is also interested in using its pipeline network to export energy resources to CA countries and Western China through Kazakhstan. This could become possible through the expansion of export infrastructure in CA countries, including the development of joint international management structures.<sup>160</sup> In this context, the prospects of developing cooperation between Russia and CA countries, as well as with the entire Caspian region, are closely linked to reestablishing a constructive and mutually beneficial dialogue between Russia and Turkmenistan.

Cooperation with CA countries in the field of transport and communications can, over the long term, become especially advantageous for Russia. This would require, however, overcoming the geographic isolation of Central Asia from major trade routes to Europe and China. Currently, the volume of goods transiting between Russia and CA countries is considerably lower compared to that achieved during the Soviet period. CA countries still extensively use Russia's transport facilities (mainly railways and pipelines) to exercise their export and import operations, while the existing structure of Russian foreign trade (mainly raw materials and energy resources exports to the world market) suggests limited use of the CA countries' transport services.<sup>161</sup> When the economic and geographical isolation of CA countries and

<sup>159</sup> A.M. Libman, M. Yu. Golovnin, "Tendencii investitsionnogo vzaimodeistviya stran SNG i mirovoi ekonomicheskii krizis", *Evrasiiskaya ekonomicheskaya integratsiya*, no. 4 (November 2010).

<sup>160</sup> Kulik et al., *Ekonomicheskie interesy...*

<sup>161</sup> V. Paramonov and A. Stokov, "Ekonomicheskie otnosheniya mezhdru Rossiei i Central'noi Aziei: osnovnye problemy", October 24, 2010, <http://www.ceasia.ru/ekonomika/ekonomicheskie-otnosheniya-mezhdru-rossiy-i-tsentralnoy-aziey-osnovnie-problemi.html>.

the interior Russian regions is bridged through a realization of land-based transport and communications projects within EurAsEC and the Shanghai Cooperation Organisation (SCO), Russia will start to capitalize upon transit through Central Asia. Regional multilateral cooperation in the sphere of transport would provide Russia with a strategically important, short and accessible land-based outlet to South Asian markets through Afghanistan's territory. The process of integration in the sphere of transport and communications within EurAsEC and SCO could, over the long term, contribute to the establishment of a powerful integration block embracing Russia, China and CA countries.<sup>162</sup>

### 9.3. Cooperation in the oil and gas sector

Russia is interested in exploiting the unique natural resource potential of Central Asia. This includes both energy resources, and strategic resources essential for restructuring and modernising Russia's industry. The presence of Russian investors in the primary sector of the region's economy is still insufficient.

Integration in oil and gas-related industries could become the critical key to promoting regional integration processes. The basic assumption of the supporters of an energy-driven strategy of integration was the fact that Russia and Kazakhstan are the two largest producers of oil and gas condensate among post-Soviet countries, exporting over 70 % of their total output. Turkmenistan is also a key producer, exporting about 67 % of its oil and close to 75 % of natural gas produced in the country.<sup>163</sup>

Still, the expansion of energy-driven integration faces a number of serious problems which could complicate the realisation of a clear-cut primary exports orientation in Russia, Kazakhstan and Turkmenistan. Hydrocarbon resources and export potential of Russia and CA countries are relatively small against the background of long-term demand for oil and gas in the world economy. According to British Petroleum data, the oil resources of Russia and CA countries account for just about 7% of total global resources, and, at the present production level, could last only until approximately 2020. In contrast, the corresponding figures for OPEC countries are 72.4 % and 100 years respectively.<sup>164</sup> The situation with natural gas production potential is much the same. The natural gas export potential of Middle Eastern countries is considerably greater than that of Russia and CA countries. The reality is that hydrocarbon resources in Russia and CA countries have greater strategic importance for these countries and their partners in the post-Soviet space, than for the world energy market.<sup>165</sup>

The establishment of an energy integration pool between Russia and CA countries is complicated by the fact that investing in oil and gas field development in these countries is less financially attractive compared to other regions of the world. The greater part of Russian nat-

<sup>162</sup> Vladimir Paramonov, "Perspektivy sotrudnichestva stran Central'noi Azii i Rossii v transportno-kommunikacionnoi sfere: osnovnye rekomendacii dlya EvrAzES i ShOS", May 14, 2011, <http://www.bsc-sw.com/articles.aspx?i=17#17>.

<sup>163</sup> V. Paramonov and A. Stokov, "Rossiia - Central'naia Aziia: neftegazovoe napravlenie ekonomicheskoi integratsii", April 2, 2010, <http://www.centrasia.ru/newsA.php?st=1270208400>.

<sup>164</sup> *BP Statistical Review of World Energy*, June 2012, <http://bp.com/statisticalreview>.

<sup>165</sup> Paramonov and Stokov, "Rossiia - Central'naia Aziia...".

ural gas resources is located in remote regions, on the continental shelf of the Arctic Ocean or in poorly developed Siberian regions, where production costs are much higher compared to the majority of other oil and gas exporting countries. Russia and CA countries are located at the periphery of the world hydrocarbon transportation network, while major world oil and gas producers are situated on ocean coastlines which facilitate shipment to major oil and gas consumers. The situation is furthermore complicated by the fragmentation of the regional economic space in Central Asia, which increases transportation costs.

In contrast to many other countries where most oil and gas produced is used for advanced processing, in Russia and CA countries these resources are predominantly used as fuel. Hydrocarbons, predominantly natural gas and heating oil, account for over two-thirds of the fuel and energy balance and are mainly used for electric power production.<sup>166</sup>

Under these conditions, the realization of the goal to increase hydrocarbon exports and to become one of the largest exporters of hydrocarbons to world markets faces many challenges within the framework of an efficient oil and gas-driven integration strategy for Russia, particularly in the longer-term perspective.

#### 9.4. Joint investments in objects of mutual interest

While the investments from CA countries do not yet represent a significant resource for the development of the real sector of the Russian economy, target-focused operations with strategically important assets by Russian investors in Central Asia are essential for Russia and are important prerequisites for the sustainable development of a number of industries of the Russian economy. So far, Russia still retains the opportunity for effective cooperation with CA countries, especially in mining and energy industries.<sup>167</sup>

The most promising areas for joint ventures with CA countries are those that could produce a sound economic effect due to considerably lower production costs in Central Asia, compared to Russia. These include the following:

- Textile and apparel industries based on primary materials produced in Central Asia;
- Machine manufacturing, including equipment for agriculture, textile, aircraft and electronic industries;
- Agricultural production, since the climate in CA countries facilitates the cultivation of crops which cannot be profitably raised in Russia;
- Non-ferrous metal industry, since major resources of non-ferrous metals of industrial value absent in Russia are found in Central Asia, including chrome, manganese and other metals; and
- Nuclear power generation, because almost all potentially profitable uranium ore deposits in the post-Soviet space are located in Kazakhstan and Uzbekistan.<sup>168</sup>

<sup>166</sup> Ibid.

<sup>167</sup> Kulik et al., *Ekonomicheskie interesy...*

<sup>168</sup> Paramonov, "Perspektivy sotrudnichestva stran..."

Despite these potential opportunities, in matters related to funding large-scale innovation and industrial projects, Russia has so far demonstrated its preference for political declarations and for cooperation in military and oil and gas spheres as less resource-intensive, as opposed to more advanced forms of economic cooperation.<sup>169</sup>

### 9.5. The role of Central Asian imports and of Russian exports for the development of export-oriented manufacturing

The significance of imports from CA countries for Russia is largely related to a clear-cut primary resources orientation of their mutual trade (see Section 2). Traditionally, Russia specialized in the processing of metallic ores and the production of refined metals from raw materials imported from these countries, particularly copper and polymetallic ores from Kazakhstan. However, the availability of home-based resources produced at a low cost, as well as low labour and environmental protection costs have led CA countries towards an extension of a technological chain, from the export of ores and minerals to deliveries of concentrates and refined metals based on investments from third countries. As a result, these countries are progressively shifting towards specialisation similar to Russian one, and are beginning to compete with Russia in international markets. For example, primary refined aluminum is produced in Tajikistan, Kazakhstan and Uzbekistan. The abolition of export duties on plain aluminum by Kazakhstan was a step towards the development of a complete export-oriented refining cycle within the country. Countries less endowed with resources, but progressively more oriented towards exports of refined metals (aluminum in Tajikistan and copper, zinc and aluminum in Uzbekistan) can in the longer term provoke an additional strain in the supply of the Russian non-ferrous metal industry with raw materials by attracting additional flows of ores and concentrates. Kyrgyzstan that used to supply to Russia mostly concentrates, now aims to develop metals refining within its own territory.<sup>170</sup>

A similar pattern is being reproduced in petrochemical and gas processing industries, in the production of mineral fertilizers and in other industries. Under these circumstances, an optimal option for Russia would be initiating and implementing joint projects with CA partners in the spheres of traditional Russian export specialization. This could be helpful in avoiding inefficient competition for markets and in affecting the price levels more effectively.<sup>171</sup>

Considering the level of economic development in CA countries and the low diversification of their export sector, considerable growth in exports of manufactured goods to Russia is unlikely in the near future. Only Kazakhstan possesses export potential large enough to impact the vast Russian market; in addition to raw materials, Kazakhstan exports sizable amounts of mineral fertilizers, non-organic chemistry products, tubes and rolled steel (see Figure 4).

<sup>169</sup> V. Paramonov, "Rossiya - Central'naya Aziya: ekonomicheskoi integracii net i ne budet", March 30, 2008, <http://www.centrasia.ru/newsA.php?st=1206874260>.

<sup>170</sup> Kulik et al., *Ekonomicheskie interesy...*

<sup>171</sup> Ibid.

Against the background of the generally shrinking Russian share in overall exports of manufactured goods from CA countries, the role of the Russian market increased for some commodity groups, including foodstuffs and textile products (see Section 2.4). Russia is a major market for CA agricultural products. According to UNCTAD, CA countries provide over 90 % of Russian wheat imports, about 70 % of barley imports, and 12-13 % of Russian vegetable and fruit imports.

However, the export potential of CA countries' agricultural sector cannot meet the demand for foodstuffs in the vast Russian market. Even Kazakhstan, the second largest regional provider of foodstuffs to the market of EurAsEC countries after Russia, has a negative balance in foodstuffs trade with Russia, with food imports seven times larger than its exports. The demand of the Russian market for organic, environmentally safe products, especially meat, vegetables and dairy products, cannot be met by Kazakhstan producers due to poor technical and technological level of agricultural production and inadequate marketability of the goods produced.<sup>172</sup>

Some of crops exported by Kazakhstan, such as wheat, barley and rice, are competitive on the EurAsEC market, while others, such as rye, buckwheat and millet, do not effectively compete with those produced in Russia and Belarus, due to an inefficient logistics network that leads to cost appreciation. Other foodstuffs from Kazakhstan that are competitive on the EurAsEC market are vegetables (bulb onion, cabbages, rather-ripe tomatoes and cucumbers), melons, gourds and apples.<sup>173</sup>

The current technological level of CA countries does not allow to view cooperation with them as a factor promoting modernization in Russia. Still, cooperation with Central Asia could provide a product market for Russian technologically advanced and innovation goods, and manufactured goods, machines and equipment which are produced in Russia but are not competitive, due to their generally low quality, technological level, etc., on the European markets. Currently, as it modernizes its production facilities with foreign investments and technology, Russia is interested in developing its exports of technologically advanced products to EurAsEC countries. The first results are already evident: for example, the Volkswagen plant in Kaluga began shipment of motor vehicles to Kazakhstan in February 2011.<sup>174</sup>

However, Russian manufactured goods are increasingly losing out to products from China, in both CU markets and in post-Soviet countries in general. As a result, exports of some commodity groups are falling (for example, those to Kazakhstan), and existing cooperation links between the enterprises of CU countries are disintegrating. Experts associate the chances of maintaining (at least temporarily) markets for manufactured goods and equipment exported from Russia with the expansion of the CU-CES.<sup>175</sup>

A potentially beneficial avenue of cooperation is the provision of a wide spectrum of Russian education services to CA countries. Expanding cooperation in this field could contribute to

<sup>172</sup> V.V. Grigoruk, "Kazakhstan na prodovol'stvennom rynke EvrAzES," *EvrAziiskaya ekonomicheskaya integraciya*, no. 3 (August 2012).

<sup>173</sup> Ibid.

<sup>174</sup> Heifets, "Modernizacionnaya orientaciya..."

<sup>175</sup> Suzdaltsev, "Ocenka i prognoz razvitiya..."

meeting the CA demand for these services, and could promote a more efficient use of the vast potential of the Russian vocational and tertiary education system that is currently experiencing a shortage of students.

## 9.6. Cross-border cooperation and security

Russia's 7,500 kilometre mutual border with Kazakhstan is one of the longest in the world. However, the potential of cross-border cooperation is far from being exploited in full. This is partly explained by the character of the near-boundary territories themselves, which on both sides of the border are for the most part developed poorly. Still, experts believe that cross-border cooperation should become a key instrument of regional economic development, contributing to promotion of security and good neighbourly relations with CA countries. For example, in Tyumen oblast, that borders Kazakhstan, cooperation offers opportunities for large and middle-scale regional businesses to access new markets in machine building, woodworking and agribusiness. Cooperation between Tyumen oblast and Kazakhstan and Uzbekistan is gaining speed in timber, light and chemical industries, machine building and cattle breeding.<sup>176</sup> Experts estimate that over 70 % of trade in foodstuffs between Russia and Kazakhstan involves cross-border trade agents.

Problems of economic cooperation between Russia and CA countries are closely linked to security issues, primarily counteracting drug trafficking from Central Asia into Russia, the scale of which is estimated to be comparable to the volume of mutual official trade (about USD 20 billion). In Russia, this problem has, apart from humanitarian impact, an economic dimension. Drug trafficking financially supports the illegal economic sector, corruption and organised crime in both Russia and CA countries. After the removal of customs control at the Russia-Kazakhstan border, through which drugs, mostly heroin from Afghanistan (that accounts for about 74 % of world opium production) and Tajikistan, penetrate into Russia, the modernization of customs posts at the southern Kazakhstan border has become a pressing issue.

In accordance with intergovernmental arrangements, CU members are responsible for control at their external frontiers. Technically, to control the southern border of the CU is easier, since the southern Kazakhstan border is half as long as the border with Russia. Besides, the northern Kazakhstan border runs through flat steppe territories, while in the south it runs along natural barriers such as mountain chains and ridges. Kazakhstan has already declared its intention to spend about USD 95 million on strengthening its southern borders over the next two years. The cost of a single stationary inspection customs complex equipped with X-ray facilities to check motor vehicles and cargo containers is close to USD 9 million.<sup>177</sup>

An effective system to counteract drug trafficking cannot be organised without close cooperation from CA countries, on the one hand, and with members of the antiterrorist coalition in Afghanistan, on the other hand. The Central Asia Counternarcotics Initiative (CACI), initi-

<sup>176</sup> A. V. Devyatkov, „Central'naya Aziya i Rossiya: razvitie transgranichnyh svyazei", June 16, 2010, <http://www.bsc-sw.com/articles.aspx?i=0#0>.

<sup>177</sup> A. Vasiliveckii, „Rossiya na igle. «Geroinovaya reka» iz CA grozit stat' vodopadom", April 14, 2011, <http://procella.ru/index.php?newsid=2606>.

ated by the United States in October 2011, could be of considerable help. CACI aims to establish task force structures to counteract drug trafficking using force in the five CA countries. Education and training of task force personnel will be provided by the US Drug Enforcement Administration (DEA). These operational teams will cooperate with their colleagues in Afghanistan and Russia, while carrying out joint operations to intercept drug traffickers and collect evidence against drug dealers.<sup>178</sup>

## 10. Conclusions

10.1. Most CA countries were republics of the USSR prior to 1991 and share a common history with Russia. Close economic relations established during the Soviet period were based on centrally planned trade and investment flows, and have not become a basis for the recovery of former cooperation. Most qualitative and quantitative indicators of economic relations between Russia and Central Asia are still much lower compared to those achieved during the Soviet Union.

10.2. Russia has forfeited its position as the only and dominant regional player and can no longer serve as the single strategic partner for CA countries. China and the EU are both ready to take up this role, and their penetration into CA economies is growing. Since third countries are increasing their impact on the economic policies of Central Asia, Russia must adjust to new realities and interact with new actors within Central Asia with regard to markets for manufactured goods and investment projects. Russia is not always able to compete effectively with these actors due to a combination of relatively weak institutions stimulating external economic activity, top-down decision-making concerning participation in large-scale investment projects, and declining potential for industrial modernization. Russia is bound to adjust its integration plans to reflect the necessities of cooperation with China and the EU.

10.3. The fragmentation of the CA regional economic space into national segments pre-determines the insularity of this region within the broader system of Eurasian land-based transport communications. The modalities of CA countries' economic relations with the rest of the world are determined by their distance from key Eurasian transit communication lines. Major land-based Eurasian communication routes bypass the region, and interior regional transportation lines (primarily railways and highways) are used primarily for export and import operations between CA countries, while other Eurasian countries, including Russia and China, use these routes much less. With intensive transport and communication development in Central Asia in the long term, the transit role of the region will change considerably, creating new stimuli for the development of multilateral cooperation by CA countries.

10.4. Currently, the following bottlenecks are preventing the expansion of cooperation between Russia and Central Asia:

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<sup>178</sup> G. Fashutdinov, "Moskva predlagaet Central'noi Azii «Korporaciyu razvitiya», April 1, 2012, [http://www.dw.de/dw/article/0,,15849665\\_page\\_0,00.html](http://www.dw.de/dw/article/0,,15849665_page_0,00.html).

- The existing pattern of economic interrelations is primarily driven by cooperation in energy and mining sectors. While it is slowly moving towards a more diversified scheme of cooperation, it is so far poorly oriented toward the modernisation of national economies, reducing long-term incentives for the development of cooperation.
- A strong dependency on top-down decision-making inhibits cooperation development, leading to the very modest participation of Russian SMEs in economic cooperation. Greater involvement by SMEs could create a critical mass for a breakthrough in economic relations and locate spheres of mutual interest even within the generally unfavorable climate for doing business in the majority of CA countries.
- Russia does not possess sufficient resources and has not yet reached a level of economic attractiveness required to capture the major economic needs and interests of most CA countries, suggesting that integration projects in CA could be successful if they involve some degree of third country participation.
- Russia's unfriendly attitude towards CA migrants and occasional xenophobia are hampering mutually beneficial productive migration.
- Controversies between the CA countries themselves, such as difficulties in implementing large-scale hydroelectric power projects.
- Central Asia includes countries at different development levels and with varying motivations regarding cooperation with Russia. This implies a different scale of involvement in joint cooperation projects. Above that, political motivations often play a crucial role in the decision-making concerning participation in these projects in CA countries.

10.5. In Russia, motivations to be involved in cooperation projects with CA countries are driven by geopolitical factors and by the internal situation within the country. The current demographic crisis, reduction of population in Siberia and trends towards concentrating economic activities in the European part of the country promote the development of economic ties with the CA region. Hence, Russia's interests are best served by coordinating and, over the long term, by implementing a single labor market regulation policy, including provisions of social assistance to migrant workers. Russia is also interested in expanding markets for its goods in CA countries, whose share in Russian exports could grow considerably due to deliveries of a wide range of manufactured products, including machinery, equipment, and knowledge-intensive goods and services. As a result of investment projects, Russia can increase the volume of direct investment stock in each of the CA countries, primarily in the real sector of the economy, and expand its cooperation deliveries of technologies and equipment using up-to-date logistics and export promotion instruments.

Russia's motivation in developing economic relations with Afghanistan warrants special attention. The main focus of current relations is attaining stabilization in Afghanistan. This includes joint projects to reconstruct and resume operations of power transmission lines, hydroelectric power stations, roads and industrial facilities, barns, and schools.

10.6. CA motives for deeper cooperation with Russia include Russia's potential to satisfy needs in investment that could contribute to the modernization of their economies in a multitude of sectors rather than in energy and primary sectors alone. Russia also represents a vast, not yet fully tapped market for Central Asian agricultural products, and is a major employer of their citizens. An abrupt drop in prices for industrial raw materials and semi-

finished products on the world market during the financial crisis vividly demonstrated the importance of the Russian market for the sustainable development of CA economies.

The majority of CA countries are also interested in the revival of humanitarian and cultural ties with Russia that have shrunk since the end of the Soviet Union, and the development of the institutional environment for more secure conditions for the millions of CA migrant workers in Russia. Numerous Russophone minorities that remained in CA countries after the collapse of the Soviet Union are interested in expanding communications with Russia and in supporting the role of the Russian language in the region.

Russia still remains attractive for potential students from CA countries. Cooperation in the sphere of education and in the training of specialists remains an important task for Russia. Since the EU is playing an active role in tertiary education in Central Asia, one approach could be close interaction between Russian and EU structures in organizing joint students exchange programs, opening departments of Russian universities in CA countries or in organising distant training courses.

10.7. The prospects of integration processes in the region are closely linked to the competitiveness of the Russian economy. Without a sound progress in modernizing and closing the current technological gap, the centrifugal processes in the region are likely to gain momentum, and CA countries will increasingly look to other partners such as the EU, China, Iran and Turkey. On the other hand, structural and technological modernisation in Russia could promote an orientation of CA economies towards Russia, creating a positive and attractive image of Russia for integration. In this situation, there would be no need to induce integration partners with non-market instruments such as customs concessions, energy and primary material import subsidies, grants and bank loans.

10.8. The CA countries have different, and often politically charged attitudes towards integration initiatives. Tajikistan and Uzbekistan do not demonstrate a pronounced intention to participate in regional integration groupings under the Russian aegis, and this attitude is sometimes manifested in driving Russian investors out.<sup>179</sup> The position of Kazakhstan, the most developed economy of the region, is based mostly on geopolitical considerations. Russian experts<sup>180</sup> believe that currently, after pipelines by-passing Russia through the Southern Caucasus were put into operation and the Kazakh banking system has matured, Kazakhstan's dependency on Russia substantially decreased. Hence its advancement from CU-CES to EAEU, that suggests a considerably higher level of supranational regulation, cannot yet be regarded as a finally settled issue.

<sup>179</sup> Alexander Libman, "Russian Federalism and Post-Soviet Integration: Divergence of Development Paths", *Europe-Asia Studies* 63 (2011):1323-1355.

<sup>180</sup> E. Vinokurov, "The Evolution of Kazakhstan's Position in Relations with Russia in 1991-2010" (*MPRA Working Paper* No. 22187, 27 April 2010), <http://mpra.ub.uni-muenchen.de/22187/>; and Ye. Zabortseva, "Transformation of Russia-Kazakhstan Post-Soviet Political Relations: from Chaos to Integration?" (Paper presented at 10th Biennial Conference of the Australasian Association for Communist and Post-communist Studies, Canberra, February 3-4, 2011), [http://cais.anu.edu.au/sites/default/files/Zabortseva\\_Transformation%20of%20Russia.pdf](http://cais.anu.edu.au/sites/default/files/Zabortseva_Transformation%20of%20Russia.pdf).

10.9. Although Russia does not fully exploit its potential for promoting the economic development of CA countries, it still remains a driving force and a key element of economic integration in Central Asia. It was Russia that initiated the legal implementation of integration processes by developing several agreements on the establishment of the EurAsEC, FTZ, CU and CU-CES within the post-Soviet space. It is at Russia's initiative that a gradual harmonization of the regulatory framework for cooperation within CIS is underway; that bilateral relations of individual CIS members with the EU, based on the concept of common economic space, are being harmonized; and that the process of standards unification is proceeding as planned. An ambitious goal set by the Russian leadership is to become an integration center for the former Soviet republics. Current efforts towards this goal have not proved to be very successful so far, and integration does not enjoy unanimous support in Russian society. A new CA generation is now receiving a western, rather than Russian, education and orientation, and increasingly perceives itself as distant from Russia. In the face of these challenges, if Russia is unable to actively initiate the expansion of the regional cooperation process, integration projects within the CU would face an uncertain future.

## Annexes

Table A1. Main indicators of export potential and development of Russia and CA countries, 2010

	Kazakhstan	Kyrgyzstan	Tajikistan	Turkmenistan	Uzbekistan	Afghanistan	Russia
World Bank country classification	UMI	LI	LI	LMI	LMI	LI	UMI
Population, million people (2010)	16.32	5.37	6.88	5.04	28.16	34.39	141.75
Per capita income (PPP, USD)	12174	2273	2163	8274	3114	1207	19840
External debt stocks (% of GNI)	94.3	89.2	53.1	2.1	19.0	19.6*	26.9
Official development assistance (% GNI)	0.3	7.0	8.3	0.2	0.6	49.6	...
Share of agricultural raw materials, %	0.6	1.2	1.2	1.1	4.1	1.1	0.9
In imports	0.2	5.3	25.3	10.6	14.5	17.3	2.1
In exports	8.5	16.9	17.7	8.7	10.9	16.2	13.1
Share of food, %	3.8	30	3.4	0.3	11.2	39.5	2
In imports	10.1	26.6	17.5	0.9	9.8	32.7	1.5
In exports	70.6	15.3	1.5	74.3	23.1	0.7	64.4
Share of manufactured goods, %	79.6	53.8	55.2	88.2	70.7	49.7	69
In imports	14.1	38.4	9.4	13.8	37.4	33.8	14.7
In exports							

Notes: UMI - Upper middle income countries; LMI - Lower middle income countries; LI - Low income countries  
\* 2008

Sources: World Development Indicators, UNCTADStat.

Table A2. Participation of CA countries in integration groups and agreements

	CIS	EurAsEC	CU - CES	CIS FTZ	CSTO	SCO	WTO	CAREC
Russia	+	+	+	+	+	+	+ (Aug. 2012)	
Kazakhstan	+	+	+	+	+	+	Request on accession (1996)	+
Uzbekistan	+	Membership suspended since 2008		+	Membership suspended since June 2012	+	Request on accession (1994)	+
Tajikistan	+	+		+	+	+	Request on accession (2011)	+
Kyrgyzstan	+	+		+	+	+	+ (1998)	+
Turkmenistan	Associated member since 2006							+
Afghanistan	Observer status, CIS Inter-Parliamentary Assembly (2006)						Request on accession (2006)	+

Sources: official websites of CIS, CU, SCO, WTO and CAREC.

Table A3.

Table A4. Comparison of import tariffs in Russia and CA countries, 2008-2010

	Russia	Kazakhstan	Kyrgyzstan	Tajikistan	Uzbekistan
	Simple average tariffs - MFN applied				
2008	10.8	6	4.7	7.9*	15.5
2010	9.5	9.2	4.6	7.8	15.4
	Simple average tariffs on non-agricultural products				
2008	10.2	4.9	4.2	7.4*	14.9
2010	8.9	8.5	4.2	7.4	14.9**
	The share of duty-free imports in the total non-agricultural products imports				
2008	11.5	26.8	51.4	...	1.5
2010	14.5	17.9	51.7	1	3.7**
	Simple average tariffs on machine and equipment groups				
I	4.2	0.7	2.6	...	9.4
2010	3.4	3.3	2.2	5	8**
II	8.8	1.5	3.4	...	13.4
2010	7.4	6.2	3.4	5	12.6**
III	10.4	2.1	4.8	...	12.6
2010	11.1	10.5	4.7	5.1	12.9**

Notes:

\* 2006

\*\* 2009

I – Non-electrical machinery; II – Electrical machinery; III – Transport equipment.

No data on Turkmenistan and Afghanistan are available.

Sources: WTO (2009, 2011).

Table A5. Select indicators of social development: Russia and CA countries

Year	Human Development Index (HDI) value	HDI rank among 189 countries	Population average annual growth (%)		Population below income poverty line (PPP \$1.25 a day, %)	Unemployment rate	Coefficient of net international migration (%)	Remittance inflows (% of GDP)
			2005-2010	2010-2015				
Russia	0.719	65	-0.4	-0.3	0.0	6.3	...	2009 0.4
Afghanistan	0.349	155	2.7	3.2	...	...	0.7	...
Kazakhstan	0.714	64	0.9	0.7	0.2	6.6	-0.1	0.1
Kyrgyzstan	0.598	109	1.5	1.1	3.4 (2007)	8.2	-0.3	21.7
Tajikistan	0.580	112	2.2	1.9	21.5 (2004)	2.2*	-0.6	35.1
Turkmenistan	0.669	87	1.4	1.2	24.8 (1998)	...	-0.1	...
Uzbekistan	0.617	102	1.4	1.2	46.3 (2003)	0.2*	-0.3	...

\* Registered unemployment

Sources: UNDP Human Development Report (2009, 2010, 2011); data on unemployment – World Development Indicators database (World Bank), International Labour Organization.

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