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CHAPTER 6

TRADE AND ECONOMIC TRANSFORMATION

With the impending enlargement of the Economic Union to 25 states (now set for 2004), a broad range of issues has arisen regarding the economic implications for the non-acceding countries and the prospects for further economic integration within the ECE region. Section 6.1 concludes that EU enlargement will have a net positive impact on the non-acceding ECE countries. One reason is that under the EU common tariff, the exports of the non-acceding states will be subject to lower average tariffs than those they currently face in a number of acceding countries. Importantly, the size of the net benefit for the non-acceding countries will also depend on their supply response. However, other enlargement effects, such as the disruption of cross-border trade as a result of the introduction of the new EU visa regime are expected to be negative. The empirical overview of CIS trade in sections 6.2(i)-(iii) documents its recovery from the collapse at the beginning of the decade and discusses some of the factors that have led to a shift from intra-CIS exchanges to increased trade with the rest of the world. Russia, however, maintains a central role in CIS trade. The CIS continue to export mainly fuels and primary commodities, while importing chiefly manufactures, particularly from the non-CIS area. Section 6.2(iv) contains a review of the evolution of regional institutions for economic integration within the CIS, concluding that they have not been very effective. It is suggested that CIS economic integration constitutes a part of the broader process of creating a "Wider Europe" and that this is where the returns to a common commercial governance are greatest. The section ends with a set of proposals for promoting trade within the CIS area.

6.1 The impact of EU enlargement on non-candidate countries in eastern Europe and the CIS

The issue of EU enlargement has spawned a large number of studies of the impact, both macroeconomic and microeconomic, of the accession of new members to the Union. These studies have ranged widely, from conventional estimates of trade creation to more speculative assessments of the likely impact of enlargement on patterns of business networking and regional development. But they have focused almost exclusively on the impact of enlargement on the existing EU and the acceding countries. This section seeks to redress the balance by concentrating on the impact of EU enlargement on the CIS and five south-east European (western Balkan) countries (Albania, Bosnia and Herzegovenia, Croatia, The former Yugoslav Republic of Macedonia and Yugoslavia) that will remain outside the EU after the current round of enlargement (hereafter, non-acceding countries). The section largely excludes consideration of Bulgaria and Romania, which are expected to accede to the EU in 2007.

(i) Introduction – a taxonomy of trade flows

In analysing the effect of EU enlargement on non-acceding states, it is useful to distinguish between three types of international trade – Heckscher-Ohlin trade, intra-industry trade and local cross-border trade, including shuttle trade. The first is driven by differences between economies in their relative endowments of factors of production, broadly defined. In terms of the non-acceding countries, this often refers to endowments of natural resources, primarily hydrocarbons but also metals, including gold; also to land well suited for the cultivation of particular crops, e.g. grain in the Black Earth region of Russia and Ukraine and the Vojvodina area of Yugoslavia, and cotton in central Asia; and to differences in capital availability and real wage rates. Vis-à-vis the rest of the world, the non-acceding countries derive comparative advantage from their natural resources and low-wage rates but suffer relative shortages of capital.

The concept of intra-industry trade extends the principle of comparative advantage to include fine differences in endowments of specific subfactors of production, usually based on specific elements of human capital or technological capability. Trade between developed industrial economies is dominated by intra-industry trade. In trade between less developed countries, intra-industry specialization is of minor importance. On a priori grounds it might be expected that the overall pattern in the CIS and the western Balkans will lie somewhere between those extremes, but with substantial differences between countries stemming from differences in levels of industrialization.

The third category, local cross-border trade, may be driven by fine distinctions of comparative advantage, by tax differences or simply by convenience as a result of the way frontiers and communications and transportation networks relate to each other. Thus, for example, the inhabitants of eastern France use Geneva airport, in Switzerland, because it is the main international airport in their region. Local cross-border trade among CIS countries is particularly important simply because for so long it was not international trade at all, and because the frontiers inherited from the territorial division of the former Soviet Union are convoluted. The fragmentation of the former SFR of Yugoslavia has similar implications for the western Balkans. Any rational transport system in the populous and fertile Fergana Valley, in central Asia, would involve crossing borders between Kyrgyzstan, Tajikistan and Uzbekistan, on a continual basis. In the Caucasus, the Nakhichevan region of Azerbaijan is cut off from the rest of that country, and road and rail transport between Nakhichevan and the rest of Azerbaijan has to cross Armenia, or go through Iran. The breakup of the Soviet Union has left Kaliningrad province, on the Baltic, geographically isolated from the rest of Russia, so that doing business with other Russian companies again necessarily implies cross-border trade with neighbouring states (in this case primarily Lithuania). The breakup of the former SFR of Yugoslavia, in leaving The former Yugoslav Republic of Macedonia independent but landlocked, has had a similar effect on that country.

A relatively high incidence of local cross-border trade can therefore be expected between CIS countries, between western Balkan countries and between Kaliningrad province and its neighbours. On the old Soviet border with the rest of the world, where in Soviet times local cross-border trade was largely forbidden (even when the neighbour in question was a socialist country), local cross-border trade might be expected to grow rapidly, an expectation borne out in the case of Poland and Ukraine. Extra dynamism has been injected into the post-Soviet development of local cross-border trade, both intra- and extra-CIS, by the phenomenon of “shuttle trade”. Because distribution was so poorly developed in Soviet times, and because exporting and importing were state monopolies, CIS countries were generally very poorly endowed with efficient import-export organizations, especially with regard to consumer goods. This gap has been filled to a remarkable extent, especially in the early years of transition, by a new breed of traders called “shuttlers” (in Russian *chelnoki*), who go back and forth across frontiers, perhaps several times a day, with suitcases full of goods to be sold on the other side. Shuttling has also been very important across the borders of Albania, Kosovo and Yugoslavia in the western Balkans. At its crudest level, shuttling is simply an exercise in arbitrage and/or tax evasion. (Note that there need be no element of smuggling as such. Shuttling is not in itself illegal, except to the extent that the goods for sale are declared to be for personal use.) It can, however, take the form of low-level intra-industry trade, especially where trade in electronic components is involved.[423] Either way, it is by definition a transitional (in the literal sense of the word) phenomenon. But it remains very important on the Polish-Ukrainian border, and in special cases such as Kaliningrad; it certainly cannot be ignored in the context of EU enlargement. It is owing to shuttle trade with its eastern neighbours that Poland joined the top 10 of tourist countries in 1997.[424]

It is particularly important in the context of former centrally planned economies to stress that comparative advantage does not always translate into competitive advantage. Gross mismanagement of traditional export sectors such as agriculture, and poor marketing across all sectors, meant that many sectors and subsectors of (in particular) the Soviet economy, with obvious strengths in terms of relative factor endowment, contributed little or nothing to exports. Because competitive advantage is embedded in particular firms, it is built slowly and with difficulty, even in mature market economies. Given the hesitant transition process that has characterized most of the CIS countries over the past 10 years, it would be unrealistic to expect the rebuilding of competitive advantage in international markets to have progressed very far. This is particularly important in relation to agriculture, which figures so prominently among accession issues. Because the former SFR of Yugoslavia operated a system of decentralized market socialism, and allowed firms a good deal of independence in relation to foreign trade, there is significantly more continuity of competitive advantage in the western Balkans than in the former Soviet Union. In a region such as Kaliningrad province, which under the former Soviet system was largely militarized and therefore highly autarkic even by Soviet standards, the process of building competitive advantage only began with the transition itself.

While one or two generalizations can usefully be made about all of the western Balkan and CIS countries not actively involved in accession negotiations, it must be recognized that post-socialist countries vary enormously in terms of their location, stage of economic development and pattern of economic specialization. At one extreme stand some of the Asian CIS countries, largely pastoral/agriculture in economic profile, and with virtually no trade with the EU. At the other stands a country such as Croatia, with a well-developed industrial sector and close trading ties with central Europe and the existing EU.

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[423] Shuttle trade in computers and computer parts between Poland and western countries was an important element in the initial development of the Polish computer and software industries in the late 1980s, just before transition proper began.

[424] K. Wolczuk, *Poland’s Relations with Ukraine in the Context of EU Enlargement,* Economic & Social Research Council, One Europe or Several? Programme, Briefing Note 4/01, April 2001, p. 2.

(ii) The impact of EU enlargement – a preliminary assessment

Before looking at how enlargement may affect the pattern of trade between accession and non-acceding countries, it is necessary to ask some simple questions about the possible effect on the volume of trade, and on economic activity in general. If enlargement boosts economic performance in the EU as a whole, and, especially, if it increases the rate of economic growth in the acceding east European countries it will have a generally expansionary impact on imports from the non-acceding countries, and therefore on their levels of GDP.[425] How large that impact will be, will depend on the strength of the boost to European economic performance, the share of the non-acceding countries in total EU imports and on the ability of those countries to respond to the pattern of increased demand. Given that many of the non-acceding countries currently export very little to the EU or the candidate countries (see annex tables 6.1-6.3), and given the prevalence of supply-side problems in these countries, it would be dangerous to assume anything like a maximal response although it should always be positive.

In terms of the basic classification of types of trade, laid out above, the Heckscher-Ohlin (Soviet oil and gas for the former GDR and Czechoslovak equipment and Bulgarian tomatoes) and intra-industry (CMEA integrated machine-building programmes) trade between the former Soviet Union and its allies largely ceased with the breakup of the CMEA in 1991, and has not been revived to a significant extent between central Europe and the European CIS (Belarus, the Republic of Moldova, Russia and Ukraine) in the post-socialist period.[426] The simple argument, therefore, is that EU enlargement will have little or no impact on this type of trade. This argument may, however, be misleading. Because the accession of the candidate countries to the EU will actually reduce their tariffs vis-à-vis the non-acceding countries on a number of important products that were the subject of Heckscher-Ohlin or intra-industry trade in the communist period (see subsection (iii)), it may actually help trade in these products to revive – assuming an elastic supply response. Also, the protectionist Common Agricultural Policy (CAP) may have a significant impact on the agricultural part of the Heckscher-Ohlin spectrum.

As noted earlier, a key nexus of local cross-border trade, including shuttle trade, in the ECE region is the Polish-Ukrainian border, which, unique among borders between eastern Europe and the CIS, stretches for several hundred miles through an economically fairly well-developed part of eastern Europe in which transport is relatively easy. Local cross-border trade is facilitated by the fact that Ukrainian citizens do not require visas to enter Poland. The total number of visits by Ukrainian citizens to Poland was 3.9 million in 1999, rising to 4.4 million in 2000. In the first six months of 2001 alone there were 2.2 million such visits.[427] It is a reasonable supposition that most of these visits involved shuttling. The numbers will certainly fall when the Polish government, in anticipation of EU membership, introduces visas for Ukrainian citizens.

Less important in quantitative terms, but possibly more important for the real incomes of the populations involved, is the shuttle trade between Kaliningrad province and neighbouring Lithuania and Poland. This trade is facilitated by the fact that, at present, the inhabitants of Kaliningrad can travel to Lithuania and Poland with only identity cards. It will certainly be affected by the introduction of visa requirements as Lithuania and Poland prepare to become EU member states. The local cross-border trade problem also affects Belarus. One source puts the number of visits to Poland by Belarusian citizens in 2000 at 5.9 million, which seems improbably high.[428] Even if it is substantially discounted, however, it suggests that the Belarus-Poland shuttle trading is more important than Belarus's overall trade orientation to the east. There appears to be little cross-border trade between the Republic of Moldova and Romania, so the latter's accession to the EU in 2007 should be of limited consequence in this regard.

Kaliningrad apart, Russia's direct connections with the accession countries are rather marginal but a certain amount of Russian shuttle trade goes through Belarus.[429] Russia has borders with three former Soviet republics, Estonia, Latvia and Lithuania, which are all EU candidates. These are short borders, but local cross-border trade across them is

[425] P. Welfens, *EU Eastern Enlargement and the Russian Transformation Crisis* (Berlin, Springer, 1999), p. 26.

[426] For Ukraine, Grubel-Lloyd indices of intra-industry trade are generally very low, and fell significantly between 1996 and 2000, even in the machinery and metallurgy sectors, where input-output relationships are generally fairly ramified, and where there is a definite tradition of international division of labour in the transition region. V. Goloven, "Notes on trade diversity in Ukraine", TACIS, *Ukrainian-European Policy and Legal Advice Centre, Quarterly Issue,* December 2001, pp. 64-69.

[427] D. Lukyanenko, *The Impact of European Union Enlargement on Ukraine,* United Nations, Economic and Social Council (ECOSOC), Economic Commission for Europe, Coordinating Unit for Operational Activities, 27 February 2002, mimeo, p. 20.

[428] V. Tarasevich, *Impact of the Enlargement of the European Union on Non-Accessing Countries, and in Particular on the Republic of Belarus,* United Nations, ECOSOC, Economic Commission for Europe, Coordinating Unit for Operational Activities, 27 February 2002, mimeo, p. 25. In comparison, Tarasevich gives a figure of 6.1 million for the number of Ukrainian visits to Poland in 2000.

[429] Tarasevich gives a figure of 2.75 million for the number of Russian visits to Poland in 2000.

important; in Estonia and Latvia this is partly because they have large Russian populations. The fact that Russian citizens already need visas to enter Estonia, however, means that the impact of Estonian accession on that trade is likely to be marginal.

A lot of Russian hydrocarbons and minerals are exported via Latvia, and this trade will probably not be significantly affected by accession. It will be much more affected by the development of Russia's new oil terminal on the Gulf of Finland, which will serve as a gateway to the Baltic Pipeline System currently under construction.[430] Indeed, these new Russian infrastructure developments seem to be aimed expressly at creating an autarkic Russian transit system in the Baltic region.[431] Latvian accession per se is likely to have more impact on the informal trade economy that runs from Russia through Latvia to the west.

One very specific enlargement issue affecting Russia is that of nuclear fuel and power station maintenance services. At present Russia commands a substantial market for these in eastern Europe based on the Russian designed and built atomic power stations located there. Accession will significantly reduce this market because Russian nuclear installations and nuclear fuel (possibly also Russian ways of transporting nuclear fuel – see the discussion of transit issues below) do not correspond to EU regulations, and because of the EU policy of diversifying energy supplies. It should be noted, too, that there is likely to be a gradual reduction of these markets already in the run-up to accession, as candidate countries progressively adopt EU technical standards,[432] and/or as Russian-built installations are closed down.

One of the basic rules of the EU is that member countries are not allowed to have bilateral preferential trading arrangements with non-member countries. For that reason, the Ukrainian-Estonian, Ukrainian-Latvian, Ukrainian-Lithuanian, Hungarian-Yugoslav, Romanian-Moldovan and several other free trade agreements will all have to be abandoned when Estonia, Latvia, Lithuania, Hungary and Romania join the EU. Ukrainian trade with Lithuania and Estonia is relatively small and the abandonment of those two free trade agreements is unlikely to seriously affect overall trade patterns, although the Lithuanian port of Klaipeda is an important transit point for Ukraine, and there is also some Ukrainian transit trade through Estonia. The same holds for Ukrainian-Latvian trade in the past, although Ukrainan exports to Latvia rose very sharply in 2000 and 2001.[433] The Romanian-Moldovan free trade agreement is in a different category. Romania is the Republic of Moldova's biggest trading partner after Russia, accounting for some 12 per cent of the latter's total exports. The forced abandonment of the agreement could have a significant negative effect on the Republic of Moldova's economy, particularly on the textile sector. Also potentially important is the Hungarian-Yugoslav free trade agreement. Signed in March 2002, and in force from 1 July 2002, it is an agreement between neighbouring countries with a substantial common border and a history of close trading links. It is, furthermore, an asymmetrical agreement, with the economically more developed Hungary giving Yugoslavia tariff-free access on 90 per cent of its industrial nomenclature, in exchange for 80-85 per cent of the Hungarian industrial nomenclature in relation to exports to Yugoslavia. It could, therefore, be an important vehicle for the revival of Yugoslav exports over the next few years – but only until Hungary joins the EU. The Slovenian-Croatian free trade agreement was superseded when Croatia joined CEFTA on 1 January 2003, but CEFTA will also cease to exist when the majority of its members join the EU.

It is clear, therefore, that many of the key enlargement factors are best analysed in terms of specific issues for specific countries or subregions. But there are three general trading issues in relation to which enlargement could have a significant effect.[434] One is transit through eastern Europe, which is vital for the Heckscher-Ohlin trade of the CIS countries. Russian officials, in particular, are very concerned about the impact that eastward enlargement of the EU, and the eastward extension of EU regulations on pipeline safety, dangerous loads, etc., might have on transit arrangements. For the time being Russian transit will be bound by EU regulations on transit safety, but it is still subject to east European regimes in relation to other aspects of transit, including tariffs.

[430] Ministerstvo Inostrannykh Del Rossiiskoi Federatsii, Departament Informatsii Pechati, "O puske pervoi ocheredi Baltiiskoi Truboprovodnoi Sistemy – BTS" (Moscow), 27 December 2001.

[431] J. Laurila, "Developments in transit transport between Russia and the EU", Bank of Finland, *Baltic Economies,* 8 March 2002, p. 4.

[432] I. Ivanov, *The Impact of the Enlargement of the European Union on a Non-Applicant Country in Transition. Case Study of the Russian Federation with Reference to Other Countries Concerned*, United Nations, ECOSOC, Economic Commission for Europe, Coordinating Unit for Operational Activities, 10 May 2002, mimeo, p. 7.

[433] D. Lukyanenko, op. cit., p. 7.

[434] A number of non-trade bilateral agreements have recently been signed between accession and non-applicant countries, e.g. a social security cooperation treaty between Latvia and Russia and a double taxation agreement between Croatia and Estonia. It is unclear how these agreements will be affected by accession.

A second issue is contingent protection. The Republic of Moldova, Russia and Ukraine have all been subject to EU anti-dumping actions in relation to steel, and the expectation is that the problem will intensify after enlargement.[435] In particular, there is concern that the European Commission may be persuaded by central European steel lobbies eager to penetrate the west European market, to impose anti-dumping restrictions on steel-makers in non-acceding countries even more frequently than happens at present. The Ukrainian Ministry of Economics estimates that EU enlargement could result in a 50-80 per cent drop in Ukrainian metal exports to the acceding countries, implying a loss of $210-$340 million in annual export revenue,[436] or 2-3 per cent of the total value of Ukrainian exports.[437] One source gives a figure of $60 million, although this refers only to "certain foundry products".[438] It is not clear how any of these figures have been calculated, and they are difficult to verify.[439] The Ukrainian Ministry of Economics appears to have made very pessimistic assumptions about the likely pattern of anti-dumping in its calculations, although economists at the Ukrainian-European Policy and Legal Advice Centre were sceptical about this argument when they were interviewed in late 2000. The issue nevertheless bears further examination. Other non-acceding countries for which steel represents a significant proportion of their exports to the EU include Armenia, Georgia, Russia and The former Yugoslav Republic of Macedonia (see annex table 6.2).[440] For Belarus, the anti-dumping problem focuses on chemicals, with exports of potassium chloride, polyester staple fibre, polyester filament tow, carbamide-ammonium mixtures and urea all subject to EU anti-dumping duties. These products are exported to the candidate countries as well as to the existing EU. According to one estimate, if current anti-dumping restrictions remain in place, Belarus will lose $140 million a year in export revenues.[441] Steel apart, Russia faces anti-dumping restrictions on a range of chemical and non-ferrous metal products. A Russian source estimates that the extension of these restrictions to the candidate countries would cost Russia $105 million annually in lost export revenues.[442] It is unclear how enlargement will affect the various voluntary export restraints (VERs), which also affect trade in sensitive sectors, notably steel, between non-acceding countries, the existing EU and the candidate countries.[443] The European Commission is currently showing flexibility in this regard, agreeing in February 2002 to a 28 per cent increase in the Russian crude steel VER for 2002-2004. In principle, Russia's problems with anti-dumping measures should be eased by the August 2002 recognition by the European Commission of Russia as a market economy and, eventually, by the country's accession to the World Trade Organization (WTO).

There is one, final, general issue which needs to be discussed at this point, although it is not strictly a trading issue – this concerns the movement of factors of production and, specifically, the impact of the extension of the Schengen regime to the new EU eastern border on the movement of labour. Millions of people from the former Soviet Union and former SFR of Yugoslavia work in other countries and regions of Europe, full-time or seasonally, some legally, many illegally. As a result workers remittances have become an important source of foreign exchange for many countries in the area (chapter 3.5(iii)). Over a million Moldovans, out of a population of 4.4 million, for instance, work abroad, many in Russia, many in Romania, a candidate country, and many in EU countries such as Italy and Portugal. Anticipation of EU enlargement is already affecting the movement of these people, as the Romanian government, for example, tightens border controls to come into line with the *acquis communautaire*. The result is that many Moldovans are taking Romanian citizenship. In general, there are positive and negative sides to that development, but it clearly tends to reduce the pool of skilled labour in the Republic of Moldova. Presumably, this tightening of controls over the movement of people across the Moldovan-Romanian border will also tend to reduce the number of Moldovans working in the countries of the existing EU.

(iii) Quantitative estimates of the impact of enlargement

[435] Central European duties on imports of heavy industrial products are, in fact, generally higher than those of the EU, so that enlargement is likely to mean a liberalization of the east European steel trade in terms of formal tariff barriers.

[436] G. Alekseev, "Ukraina fakticheski okazalas' v torgovoi izolyatsii", *Kievskie Vedomosti,* 11 November 2000, p. 9.

[437] The Ministry estimates the total loss of exports due to enlargement in the range of $750-$950 million, some 6-7 per cent of the total value of exports.

[438] D. Lukyanenko, op. cit., p. 9.

[439] Ukraine does not report export data by branch to the United Nations COMTRADE Database.

[440] The only non-acceding countries for which steel represents a significant proportion of exports to CEFTA-5 and the Baltic countries are Albania and Kazakhstan. In both cases, however, the absolute figures are small. See annex table 6.3.

[441] V. Tarasevich, op. cit., p. 8.

[442] I. Ivanov, op. cit., p. 7.

[443] E. Kawiecka-Wyrzykowska and D. Rosati, *The Impact of Accession of Central European Candidate Countries to the European Union on Russia, Ukraine and Belarus. Trade and Investment Effects*, United Nations, ECOSOC, Economic Commission for Europe, Coordinating Unit for Operational Activities, June 2002, mimeo, p. 39.

Many of the issues touched on in the last section are beyond precise quantification. In particular, the accession factors which turn on visa regimes and the like can only be assessed in terms of orders of magnitude. But EU enlargement does involve quite specific changes in the trade regimes of the new member states, in particular, the substitution of the various national tariff systems by the EU common tariff, the adoption of the EU generalized system of preferences (GSP) schemes (which will benefit the non-acceding countries), and the adoption of the Common Agricultural Policy. The EU common tariff consists of tariff rates that are both higher and lower than the current national tariffs applied in the acceding states. The impact of the introduction of the EU common tariff on the non-acceding countries will depend on the commodity composition and destination of their exports (some acceding countries already have low tariff rates). It appears that in a number of cases the average EU tariff that non-acceding countries will face in the accession countries is lower than their current average national tariffs.

The impact on GDP of the substitution of the EU common tariff can be estimated using computable general equilibrium (CGE) models. There is considerable experience of using these models to estimate the impact of successive waves of European integration.[444] CGE models are limited to the extent that they encompass only the short-term trade creation and diversion effects of economic integration. Perhaps for that reason, they tend to generate fairly modest estimates of the impact of integration – generally of the order of 1-2 per cent of GDP.[445] But while CGE estimates cannot claim to catch all the effects of changes in trade regimes, they do represent the logical first step in any attempt to assess the impact of EU enlargement. The quantitative impact of changes in trade regimes, specifically on exports and imports, can also be estimated on the basis of methodologically analogous gravity models.[446]

There are hardly any studies quantifying the effects of enlargement on non-acceding countries. However, useful insights can be gained from an early paper, which looked at the impact of enlargement on Slovakia if it had been excluded from accession. Fidrmuc has estimated the impact of EU enlargement on the foreign trade of Slovakia using a gravity model approach.[447] He compares the different outcomes in terms of Slovakia's trade with three of its neighbours –the Czech Republic, Hungary and Poland – under three scenarios – namely, that none of the candidate countries manage to accede (non-enlargement); that the Czech Republic, Hungary, Poland and Slovakia all manage to accede (enlargement); and that the Czech Republic, Hungary and Poland manage to accede, but not Slovakia (exclusion). He models non-enlargement trading patterns between Slovakia and the existing EU on the former free trade agreements between the EU-12 and the European Free Trade Association (EFTA) countries, and non-enlargement trading patterns between Slovakia, on the one hand, and Poland and Hungary on the other, on trade between EFTA countries. (In reality, these latter trade relations are governed by the Central European Free Trade Agreement – CEFTA.)

A summary of the results is presented in table 6.1.1. The most striking result is that, under exclusion, Slovakia's trade with Hungary and Poland actually grows faster than it would have if none of the countries involved had joined the EU. This is because EU membership for Hungary and Poland will reduce significantly their trade barriers at the new EU external border (as well as eliminating them altogether vis-à-vis existing EU countries). The pattern is not repeated for the Czech Republic because of Fidrmuc's assumption that in the special case of two countries which have only recently separated, trade patterns under non-enlargement would be similar to those under enlargement. The analogy with other non-acceding countries is clearly with Hungary and Poland rather than the special case of the Czech Republic. Thus, Fidrmuc's research highlights a key feature of the enlargement process – that because EU trade barriers vis-à-vis the rest of the world are generally lower than those prevailing in the accession countries, the basic trade effect of enlargement in terms of trade with non-acceding countries is a liberalizing one. Of course, trade with the non-acceding countries would grow even faster if they were included in the Union.

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[444] R. Baldwin, J. Francois and R. Portes, "The costs and benefits of eastern enlargement: the impact on the EU and eastern Europe", *Economic Policy,* April 1997, pp. 125-170; A. Smith and M. Gasiorek, "Measuring the effect of '1992'", in D. Dyker (ed.), *The European Economy,* Second Edition (Harlow, Longman, 1999).

[445] A. Smith and M. Gasiorek, op. cit.

[446] R. Baldwin, *Towards an Integrated Europe* (London, CEPR, 1994).

[447] J. Fidrmuc, "Trade diversion in 'left-outs' in eastward enlargement of the European Union: the case of Slovakia", *Europe-Asia Studies,* Vol. 51, No. 4, June 1999, pp. 633-645.

TABLE 6.1.1

Projections of Slovak exports to the Czech Republic, Hungary and Poland

(Average annual percentage growth rates)

	Actual 1995-1996	Non-enlargement 1997-2010	Enlargement 1997-2010	Exclusion 1997-2010
Czech Republic [a]	4.61	-0.96	-0.96	-6.07
Hungary	5.01	2.97	6.10	3.97
Poland	50.17	6.94	10.18	7.98

Source: J. Fidrmuc, "Trade diversion in 'left-outs' in eastward enlargement of the European Union: the case of Slovakia", *Europe-Asia Studies,* Vol. 51, No. 4, 1999, pp. 639-640.

a The impact of non-enlargement and enlargement is assumed to be the same in this case.

Table 6.1.2 shows that, in relation to agriculture, where the CAP introduces a substantial degree of interference in trade flows at the external EU border, Slovak exports to Hungary and Poland, under the assumptions of the gravity model, would also grow faster under exclusion than under non-enlargement. Indeed, it is agriculture that drives Fidrmuc's general exclusion result, with Slovakian industrial exports to Hungary and Poland projected to grow more slowly under exclusion than under non-enlargement. The explanation for this is that CAP rates of border protection on many agricultural commodities are lower than the corresponding CEFTA rates, which Fidrmuc uses in his model. It is slightly odd that such an important result should be derived from such a crude approximation to the institutional and parametric reality. It should be said, however, that for a number of agricultural commodities in which central European countries probably enjoy comparative advantage, including vegetables, fruit and nuts, oil seeds and some meat and animal products, CAP rates of border protection are significantly lower than existing levels of protection. In practice, supply-side problems, as discussed above in relation to the realization of comparative advantage, would probably mean that the growth rates of agricultural exports that come out of Fidrmuc's model would not in practice be achieved. But this is merely to underline the fact that the problems of agriculture in eastern Europe are largely internal rather than external.

TABLE 6.1.2

Projections of Slovak agricultural exports to the Czech Republic, Hungary and Poland

(Average annual percentage growth rates)

	Actual 1995-1996	Non-enlargement 1997-2010	Enlargement 1997-2010	Exclusion 1997-2010
Czech Republic [a]	-10.66	11.03	11.03	-7.27
Hungary	2.72	10.31	26.85	12.43
Poland	68.52	8.24	24.47	10.33

Source: J. Fidrmuc, "Trade diversion in 'left-outs' in eastward enlargement of the European Union: the case of Slovakia", *Europe-Asia Studies,* Vol. 51, No. 4, 1999, pp. 639-640.

a The impact of non-enlargement and enlargement is assumed to be the same in this case.

In a more ambitious study based on the CGE methodology, Frandsen, Jensen and Vanzetti estimate the impact of the accession of seven candidate countries[448] on EU agricultural trade with the rest of the world, and the consequent effects on national income and welfare.[449] They base their modelling on the Agenda 2000 proposals for reform of the CAP, and construct a scenario for 2005 on that foundation. Their general conclusion is that the impact of enlargement in terms of agricultural trade will be marginal. Imports in 2005 from the major agricultural areas of the United States, South America and sub-Saharan Africa decline by $0.5-$1 billion. Agricultural imports from the CIS actually increase very slightly. The key to these trends is the increase in the import of vegetables, fruit and nuts etc. from the rest of the world into the acceding countries. These are product categories which are not heavily protected by the CAP, and in which CIS countries such as the Republic of Moldova enjoy comparative advantage. Frandsen et al. do not separately model the western Balkans, but it is reasonable to assume that here, also, the impact would be marginal – probably marginally positive, given the comparative advantage that the west Balkan countries enjoy in the production of vegetables, fruit and livestock products. Frandsen et al. find that the impact of enlargement on national income through changes in agricultural trade is negligible at the world level. For the CIS taken alone, they estimate an aggregate loss of $133 million, or 0.03 per cent of national income.

In basing their modelling on the provisions of the Agenda 2000, Frandsen et al. assume that:

- Intervention prices for grains, milk and cattle meat are reduced;
- Compensatory payments with respect to arable crops and livestock are adjusted;
- The set-aside rate for reform crops is reduced from 14 per cent in 1995 to zero in 2005;
- New output subsidies on cattle and raw milk are introduced;
- The milk quota is increased by 2 per cent over the period 1995-2005;

448 Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia.

449 S. Frandsen, H. Jensen and D. Vanzetti, "Expanding 'Fortress Europe': agricultural trade and welfare implications of European enlargement for non-member regions", *World Economy,* Vol. 23, No. 3, February 2000, pp. 309-329.

- All direct payments are effectively deflated by 2 per cent per annum, since they are fixed in nominal rather than real terms.

In practice, considerable uncertainty remains over the extent to which these measures will be implemented. The increases in border protection on the majority of agricultural products that will be implemented on enlargement are strictly against WTO rules, and this may yet turn into a serious negotiating issue. The EU is in any case in dispute with the WTO over the legality of direct payments. Disputes with the WTO apart, the fact is that direct payments from the EU to farmers in the accession countries will be below those established for the existing EU members.[450] At the EU summit in December 2002 it was decided that direct payments would start at 25 per cent of EU levels in 2004 and would rise to 100 per cent over 10 years.[451] It should be added, in this context, that Frandsen et al. do, in fact, test the robustness of their model by excluding direct payments to central European farmers. They find that this does not have a critical impact on their results.[452]

A final assessment of the Frandsen et al. study must take account of the inherent limitations of CGE methodology, as discussed above. The extension of the CAP to the acceding countries may release dynamic forces capable of transforming the whole basis of agricultural trade between the (enlarged) EU and the rest of the world, including the non-acceding transition countries. Large-scale investment in the agricultural sector of the acceding countries by multinational companies, for instance, could transform the supply side of their agriculture. But there is no guarantee that investment on the scale required would be forthcoming, and resistance to such a transformation from the local farm populations would surely be strong. Overall, it seems reasonable to use the results of the Frandsen et al. study as a baseline forecast, always bearing in mind that there is a whole range of factors that may modify the forecast in particular cases. Dynamic factors apart, the approach is highly aggregative, and aggregate results may conceal critical effects in relation to particular subsectors and/or countries.

What is true for agriculture in relation to dynamic effect is true *a fortiori* for trade as a whole. As argued above, the impact of the replacement of national systems of border protection in the acceding countries by the EU system on the "new" EU border is generally liberalizing. Taking dynamic factors into account could only strengthen the impact of that liberalizing tendency (e.g. with factories being built in Belarus to supply the (enlarged) EU market). That leads to the crucial issue of investment, which is taken up below. The next task is to extend the analysis to some of the key problem areas discussed briefly in subsection (ii), having due regard to potential dynamic factors, and to the impact of non-trade parameters (such as visa regimes) on trade and production patterns.

(iv) The trade in enriched uranium

Russia is a major exporter of enriched uranium. That trade is highly regulated, and its pattern is largely determined by agreements between the Russian and United States governments and the EU. But Russia also currently exports substantial amounts of enriched uranium to eastern Europe, including to some of the accession and candidate countries. In the context of EU enlargement, this poses two main problems for Russia:

1) The EU is putting pressure on some of the accession and candidate countries to close down their nuclear power stations, on safety grounds. Thus, the size of the total market for enriched uranium in eastern Europe may contract considerably in the run-up to accession;
2) The EU system of regulation of the trade in enriched uranium is much stricter than those of Russia and the individual east European countries. If Russia wants to continue to supply enriched uranium to these countries after accession, it will have to conform to EU regulations. Furthermore, the EU policy of diversification of energy supplies also applies to enriched uranium. Quite apart from the trends in the overall size of the enriched uranium market in the region, therefore, accession could mean a reduction in Russia's share of the market.

The precise outcome of the operation of these factors is difficult to predict. Some of the accession and candidate countries have intergovernmental agreements and long-term supply contracts with Russia relating to nuclear fuels, and due account will have to be taken of these within the framework of Article 105 of the Euratom Treaty. There is no *acquis communautaire* as such on nuclear safety, and the schedule for closing down the 10 nuclear power stations of the

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[450] At the EU summit of October 2002, the EU agreed to freeze overall agricultural expenditure until 2006, after which it will be allowed to increase by just 1 per cent per annum. In addition, it was confirmed that reference levels for quotas of agricultural products from newly acceding countries would be set well below potential output levels. At the same time the summit agreed that some €1.3 billion a year be set aside to ensure that no new member state ends up paying more into the EU budget than it receives from it.

[451] *Financial Times*, 10 December 2002.

[452] S. Frandsen et al., op. cit., p. 326.

Chernobyl (RBMK) type[453] located in eastern Europe is very much a matter of negotiation between the EU and national governments. The precise parameters of the diversification policy may also be negotiable. Secondly, there is no reason of principle why the Russian nuclear industry should not be able to come to terms with EU regulation of the trade in enriched uranium – after all, Russia already exports enriched uranium to the existing EU.[454] Russia and the EU have already made joint commitments in relation to nuclear security in the context of the trade in energy within the framework of the EU-Russia Energy Partnership (see below). That eastward enlargement will reduce the size of the Russian market for enriched uranium in eastern Europe is certain, but the size of the reduction is unclear.

(v) Hydrocarbons and hydrocarbon transit

Russia is a major supplier of oil and natural gas to eastern and western Europe, and this poses a number of problems for the Russian government and for the Russian oil and gas industries, namely:

- It is the general policy line of the EU that long-term contracts for energy supply should be avoided. The Russian standpoint is that, particularly with relation to gas, long-term contracts are vital if the risks of gas field development are to be kept within reasonable limits. As noted below, agreement has been reached between Russia and the EU recognizing a role for long-term supply contracts, but issues such as what could be the duration of a long-term contract and whether long-term contracts should be allowed for transit/transportation are still to be resolved. This is a general problem in EU-Russia relations.[455] It will be exacerbated by enlargement because Russia stands to lose the existing long-term contracts it has with the acceding countries;
- For historical reasons, the acceding countries rely almost exclusively on Russia and other countries of the CIS for their gas supplies. However, EU policy and domestic political considerations make it likely that some diversification of their supplies will occur, probably to the detriment of the Russian gas industry. Diversification is facilitated by the EU policy of seeking to remove destination clauses (which specify end-users) from gas contracts;
- Current Russian gas supply and pipeline service contracts with eastern Europe are generally a mixture of cash and barter elements. Implicit "real" prices are difficult to ascertain, but invoiced prices tend to be low. After accession to the EU, the barter element will have to be removed, as contracts are standardized to the norms of EU commercial law, and prices of gas and pipeline services will be brought up to EU levels. There is some anxiety on the Russian side that the prices of pipeline services (paid by Russian organizations) may be "normalized" more rapidly than the prices of gas (paid to Russian organizations);
- EU standards of pipeline safety (affecting gas and oil pipelines) are generally higher than those of the acceding countries. After accession, these standards will be imposed in the new member states, and the burden of meeting the costs of upgrading the pipelines will fall mainly on the supplier, i.e. in most cases Russia.

It is impossible to quantify the likely impact of these problems, but in some cases, Russian concerns may turn out to be groundless. For example, during the Cold War EU countries were discouraged from relying on a single source for more than one third of their energy supply. However, EU states no longer seem to consider this a constraint because Russia has been viewed as a reliable supplier of natural gas and further supply diversification would increase the cost of gas imports. Some of the questions raised above may be resolved by negotiations going on under headings other than EU enlargement (see below). But energy trade problems are currently having a serious effect on the atmosphere of EU-Russia relations, and this must have a secondary impact on the crucial matter of investor confidence vis-à-vis the hydrocarbon resources of the countries of the CIS.

(vi) EU enlargement and WTO accession

Many of the non-acceding countries are, for the time being, non-members of the World Trade Organization, among these being Russia and Ukraine. It is possible that the acceding states will have become EU members (in 2004) before Russia and Ukraine are able to join the WTO. This would have a number of serious implications for those

453 These are considered to be dangerous on two grounds. First, they do not have cooling systems adequate to cope with accidents. Second, they suffer from the gap closure problem, whereby "fuel rods in the graphite core of the reactor [may] expand to the point where they no longer fit in their 'sleeves'. This can cause rupturing of the fuel rods, which in turn could lead to a serious accident." See also M. Lohtander, "EU enlargement and the Baltic states – implications and challenges", a paper presented at the Institut für Europäische Politik Workshop (Bonn), 22 June 1999, and published in the official report of the Workshop by The Finnish Institute of International Affairs, September 1999.

454 At the end of 2001 the Russian government and Euratom signed an agreement on the sale of enriched uranium for use in the research reactor at Petten, in the Netherlands. Ministerstvo Inostrannykh Del Rossiiskoi Federatsii, Departament Informatsii Pechati, "O podpisanii Soglasheniya mezhdu Pravitel'stvom Rossiiskoi Federatsii I Evropeiskim soobshchestvom po atomnoi energii o postavkakh vysokoobogashchennogo urana dlya issledovaltel'skogo yadernogo reaktora v gorode Pettene (Korolevstvo Niderlandov)" (Moscow), 27 December 2001.

455 T. Adams, "EU-Russian energy relationships", presentation to the Department of Trade and Industry (DTI) (London), 19 June 2001, p. 6.

countries (and for other countries such as Belarus and Kazakhstan, which are likely to find themselves in the same situation):

- With the firms of the acceding states coming under the protection of the European Commission, and with non-EU/non-WTO countries unable to cite GATT rules in trade disputes, the governments of the latter countries would find it more difficult to defend the interests of their firms abroad;
- Were the EU stance on contingent protection to become more aggressive as a result of enlargement (as discussed earlier), non-EU/non-WTO countries would find themselves without the protection provided by WTO membership against unreasonable trade remedies;
- EU enlargement will result in higher rates of border protection for a number of commodities, particularly agricultural. As noted above, this is strictly against WTO rules. Since all of the acceding countries are WTO members, the non-acceding WTO member countries would be able to claim compensation for these effective tariff increases. Non-EU/non-WTO countries, however, would be able to claim nothing;
- The same applies to free trade agreements between acceding and non-acceding countries. Non-acceding countries which are members of the WTO will be able to claim compensation for the forced abandonment of these agreements. Non-WTO countries will be able to claim nothing.

(vii) What are the chances of special arrangements in trade and trade-related matters for the non-applicant countries?

All of the CIS countries (except Tajikistan) have Partnership and Cooperation Agreements (PCAs) with the EU, and all the CIS countries have signed the Energy Charter,[456] although Russia has not ratified it. PCAs provide for MFN treatment of CIS goods,[457] and they establish a number of key, level playing field conditions, e.g. with respect to foreign investment. In principle, the Energy Charter should guarantee security of transit for hydrocarbons through Europe, a prime concern for the Russian government and the EU alike. In practice, these agreements have not made a big impact on the key trade and integration issues affecting Europe and Eurasia. Partly for this reason, there are on-going negotiations between the EU and a number of CIS governments about enhancing the framework for bilateral economic relations. In the Russian case, attention has focused on the development of an EU-Russia Energy Partnership, and on the concept of a Common European Economic Space (CEES) (Obshchee evropeiskoe ekonomicheskoe prostranstvo).

In the Joint Communiqué on the energy dialogue published at the end of the Russia-EU summit, held in Brussels in October 2001,[458] the co-signatories stressed the importance of technical security of transit of hydro-carbons, and "recognized the role" of stable, long-term contracts for energy deliveries. To what extent this represents a movement on the part of the EU towards the Russian position on long-term contracts is not clear.[459] It was decided to create a "high-level Committee for Cooperation in the Field of Fuel and Energy", which will operate within the framework of the PCA. The first report of the new Committee was due in Spring 2002. If a report was made at that time, it does not appear to have been published, although there are references to a "report from high-level coordinators of the Russia-EU Energy Dialogue" in the documents from the EU-Russia summit of 29 May 2002. What did appear in March 2002 was a European Commission Staff Working Paper, which detailed significant progress on a number of important issues of EU-Russia energy relations.[460] On the problem of destination clauses within gas contracts, three-way discussions have been held between the European Commission, the Russian government and Gazprom. Gazprom has indicated that it is prepared to drop destination clauses in future contracts, and to discuss options for removing them from existing contracts. The Joint Communiqué from the May 2002 summit reported further progress on this matter. On safety, too, significant progress has been made. Gazprom is to build an EU-Russia gas certification centre for testing new, gas-related technologies. And there is to be a feasibility study, under the auspices of TACIS, of a satellite-based accident prevention and surveillance system for oil and gas pipelines using the Russian GLONASS and European GALILEO (under development) navigational systems.[461] Such a system might ultimately cover the transit countries, such as

[456] The Energy Charter covers trade in energy carriers, the promotion and protection of investment in energy sectors, and sovereignty issues as they relate to energy. It is based on the MFN principle and includes a disputes mechanism.

[457] The CIS also benefit from the EU's GSP scheme.

[458] Ministerstvo Inostrannykh Del Rossiiskoi Federatsii, Departament Informatsii Pechati, "Sovmestnoe zayavlenie po energeticheskomu dialogu" (Moscow), 4 October 2001.

[459] In the Joint Communiqué it is stated that the Russian side stresses the importance of long-term contracts for gas supply on a "take or pay" basis.

[460] European Commission, *Energy Dialogue with Russia – Progress since the October 2001 EU-Russia Summit,* Commission Staff Working Paper, SEC (2002) 333/1 (Brussels), 21 March 2002.

[461] *EU-Russia Energy Dialogue. Second Progress Report* (Brussels/ Moscow), May 2002, p. 2.

Belarus and Ukraine, as well as Russia and the EU. On the issue of the trade in nuclear fuel, there has been less progress; but there is a joint commitment to continue to search for a solution within the framework of Article 22 of the PCA. Overall the Energy Dialogue is proving to be a significant forum for the discussion, even resolution, of some of energy issues related to enlargement.

The October 2001 Russia-EU summit held in Brussels also set up a "High-level Group" to press forward with the elaboration of the idea of the Common European Economic Space, again within the framework of the PCA. The High-level Group is not expected to report definitively to the Russia-EU summit before October 2003.[462] In a progress report to the EU-Russia summit of 29 May 2002, the High-level Group stressed the importance of regulatory convergence, picking out standards, technical regulations and conformity assessment, customs, financial services, accounting/auditing, transport, space launches, public procurement, telecoms and competition as key areas of common work.[463] While some of these specified areas clearly relate to trade matters, e.g. space launching, there was no mention of the free trade issue as such. Overall, the current debate on the CEES does not touch more than marginally on the impact of enlargement.

The Ukrainian government has shown some interest in using its PCA with the EU as a basis for creating a Ukraine-EU free trade area. The EU response to this proposal has been lukewarm, stressing rather the importance of fully implementing the provisions of the PCA, especially in the fields of trade and investment. The Ukrainian Prime Minister stated on 19 March 2002 that Ukraine hopes to become an associate member of the EU by 2007. That would effectively give Ukraine free trade with the EU. The Republic of Moldova-EU PCA includes a reference to the possibility of creating a Republic of Moldova-EU free trade area,[464] but the matter has not been taken up in discussions between the two sides.

(viii) The special problem of Kaliningrad

The Russian province of Kaliningrad presents special problems in relation to EU enlargement. With the breakup of the Soviet Union, Kaliningrad province was left as an "exclave", physically separated from the rest of Russia, and dependent on transit across Lithuania, or by sea to St. Petersburg, for surface travel to the rest of the country. This, combined with the massive scaling down of the military presence in the province,[465] has created huge economic and social problems. Attempts to develop Kaliningrad as a special economic zone (SEZ) have met with opposition, first from the military and subsequently from the Russian government in the late 1990s. The present government, however, seems inclined to press forward with the project, having promised a new Federal Law on the Special Economic Zone on the Territory of the Kaliningrad Region.

Table 6.1.3 presents basic socio-economic data for Kaliningrad province. The population of the province is small and declining. The rate of natural increase of the population is sharply negative, and only significant net immigration prevents the population from falling more rapidly. The unfavourable rate of natural increase of the population reflects high levels of pollution, largely the legacy of the Soviet military period, of alcoholism, and of HIV infection and drug abuse. GDP and industrial production have picked up a little in recent years, but the level of GDP per head remains very low, even by Russian standards. It is estimated that the actual level of real GDP, taking into account Kaliningrad's vibrant second economy, is approximately twice that of reported GDP. Even so, unemployment is high and one third of the population lives below the poverty line.

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[462] Ministerstvo Inostrannykh Del Rossiiskoi Federatsii, Departament Informatsii Pechati, "Sovmestnaya gruppa Rossiya-ES vysokogo urovnya po razrabotke kontseptsii obshchego evropeiskogo ekonomicheskogo prostranstva (OEEP)" (Moscow), 4 October 2001.

[463] European Commission, External Relations Directorate General, *Report to the EU-Russia Summit of 29 May 2002 of the High-level Group on the Common European Economic Space,* 2002.

[464] As does the Russian.

[465] Between 1991 and 2001 the number of military personnel in the province fell from 200,000 to 18,000. European Commission, *Communication from the Commission to the Council: The EU and Kaliningrad*, COM (2001) 26/F (Brussels), 17 January 2001, annex 1, p. 12.

TABLE 6.1.3

Basic indicators for Kaliningrad, 1998-2000

TABLE 6.1.4

Industrial production by branch in Kaliningrad, 1998-2000

(Percentages, total industrial production 100, large and medium-sized enterprises only)

TABLE 6.1.5

Kaliningrad's foreign trade, 1998-2000

(Million dollars)

	1998	*1999*	*2000*
Exports	327.9	287.7	452.5
[illegible]	[illegible]	[illegible]	[illegible]

Source: *Federal'naya Tselevaya Programma Razvitiya Kaliningradskoi Oblasti na Period do 2010 goda*, December 2001, p. 12; UNECE secretariat calculations.

Source: *Federal'naya Tselevaya Programma Razvitiya Kaliningradskoi Oblasti na Period do 2010 goda*, December 2001; UNECE secretariat calculations.

Source: *Federal'naya Tselevaya Programma Razvitiya Kaliningradskoi Oblasti na Period do 2010 goda*, December 2001, p. 9; UNECE secretariat calculations.

a The corresponding figure for Russia as a whole is $1,783.

b It is not clear whether these are average or end-year figures.

c The corresponding figure for Russia as a whole is 10.4 per cent (average)/9.8 per cent (end-year).

Kaliningrad has a very traditional, Soviet-type structure of industrial production (table 6.1.4). The fuel and energy complex predominates to an enormous extent, but this reflects difficulties and inefficiencies in energy supply rather than any comparative advantage. The wood and paper industry is based on local timber, but is a major polluter. The strength of the machine-building and metal-working industry reflects a concentration of human capital which, up to now, only BMW among foreign firms has sought to exploit.

Table 6.1.5 brings out starkly the peculiarities of Kaliningrad's position within the international trading system. Although part of Russia, the province has hardly any trade with the rest of the country, or even with CIS countries such as neighbouring Belarus and Ukraine. The great bulk of Kaliningrad's trade is with the EU and the acceding states. Kaliningrad runs a large balance of trade deficit although it is possible that the official figures exaggerate it. A large proportion of Kaliningrad's foreign trade is conducted by shuttlers, who travel back and forth across the border, buying goods on one side and selling them on the other.[466] Many of the shuttled goods are in fact smuggled, so they do not enter the official trade statistics. At the level of day-to-day consumer goods, shuttlers seem to import more into Kaliningrad than they export. On the other side of the trade balance, however, the bulk of amber exports from Kaliningrad are smuggled.

The special problems of Kaliningrad province in connection with enlargement can be listed as follows:

- Given the predominance of shuttle trade between the province and the surrounding countries, the introduction of an EU visa regime could seriously disrupt trade and threaten the meagre standard of living of the population;
- Kaliningrad currently obtains most of its electricity from Russia, via power cables that cross Lithuania.[467] On joining the EU, Lithuania expects to link up with the central European power grid. This would cut Kaliningrad province off from the Russian grid, and force it to buy its electricity from other countries. The annual extra cost, according to the Russian Ministry of Economic Development and Trade, would be in the region of $135 million;
- There is a danger that Kaliningrad province may become isolated in a transport sense, with the port of Kaliningrad unable to compete with neighbouring Baltic ports for the Baltic transit trade.

Of these three factors, the last is perhaps the least critical in relation to enlargement, in the sense that much of the damage has already been done. The port of Kaliningrad is operating at only 30 per cent capacity, partly because it cannot compete with the other Baltic ports, even for domestic Russian trade.[468] In this context, the Russian authorities would prefer to see the ports of the region cooperating and dividing up the cargo market, rather than competing;[469] this approach, however, is unlikely to find much favour with the European Commission. The energy problem is perhaps the most intractable, and is a matter of particular concern to the Russian government.[470] In September 2002, negotiations were held between the EU and Russia on a range of issues at which time the EU clarified that it is ready:[471]

- To help with the cost of creating more and better border crossings;
- To implement the provisions of the a*cquis communautaire* in relation to the range of visa types that may be issued, i.e. transit, short-term, long-term, multiple-entry;
- To consider the possibility of introducing "further rules on small border traffic" to facilitate cross-border trade;

[466] In an interview with Radio Mayak-24 on 4 June 2002, Deputy Minister of Foreign Affairs Sergei Razov stated that 960,000 people cross the Kaliningrad border by rail every year, with corresponding figures of 110,000 and 500,000 for air and road.

[467] Kaliningrad's gas comes by pipeline across Belarus and Lithuania.

[468] European Commission, *Communication from the Commission …*, op. cit., p. 13; A. Rüesch, "Kaliningrad: back to isolation? Dim prospects for Russia's European outpost", *The Giacometti Portfolio*, 12 February 2002 [nzz.ch/English/background/2001/08/03_Russia.html].

[469] Ministry of Foreign Affairs of the Russian Federation, *Daily News Bulletin*, 6 March 2002.

[470] "Senior Russian minister voices concern over the future of Kaliningrad region", *BBC Monitoring Former Soviet Union – Political* (London), 16 February 2002.

[471] *Financial Times*, 27 and 28 September 2002.

- To encourage member states to set up consular offices in Kaliningrad;
- To conclude a readmission agreement[472] with the Russian government.[473]

It is difficult to estimate what the total impact of all these measures might be. The proposal regarding small border traffic is clearly the most important, but it is the least clearly defined in terms of scope at the present time. Even on the most favourable interpretation, movement across Kaliningrad's borders will surely become more difficult than it is at present once enlargement becomes a reality. Given the peculiar structure of the province's trade, this is bound to have a significant effect. It should be noted, in this connection, that the EU visa regime will come into force, not immediately upon accession, but when controls on the movement of people across the existing border between the EU and the candidate countries are completely removed. There could be a delay of several years after accession before that stage is reached. On the other hand, some candidate countries have decided to anticipate their accession to the Schengen Agreement in this respect.[474]

At the EU-Russia summit of 11 November 2002 agreement was reached on the issue of transit from Kaliningrad, through Lithuania, to the rest of Russia. Under the agreement, residents of Kaliningrad will be able to travel to Russia proper on the basis of a new Facilitated Transit Document (FTD) scheme, which is to come into effect by 1 July 2003.[475] As regards travel through Kaliningrad into neighbouring states, the normal visa regime will apply.

It is not clear beyond all doubt that on balance EU enlargement will greatly damage the Kaliningrad economy. There will certainly be negative impacts, but in some cases those may have positive implications. Thus, for instance, to the extent that tighter visa controls reduce the criminal element in shuttling, they may do something to weaken organized crime in the province, one of the factors inhibiting economic development. There will, moreover, be some clear-cut benefits, in addition to the general positive impact of reduced tariffs on the Russian economy as a whole. One of the main concerns of the Russian government about Kaliningrad is the current regime of tariffs on the transit of goods between the province and the rest of Russia, which, it claims, is discriminatory.[476] Once the transit countries are inside the EU, Kaliningrad will start to benefit from the provisions of Russia's PCA, which forbids any such discrimination.[477]

(ix) The western Balkan countries

The EU's relations with the western Balkans – Albania, Bosnia and Herzegovina, Croatia, The former Yugoslav Republic of Macedonia and Yugoslavia – are governed by the Stability Pact, launched in June 1999 (which also covers Bulgaria and Romania).[478] In addition to channelling large-scale economic aid to the region, the Stability Pact provides a framework for strengthening economic ties between the region and the EU, under the rubric of the Stabilization and Association Process. The medium-term goal for the EU is to negotiate specific Stabilization and Association Agreements (SAAs) with each of the five countries. To date, such agreements have been signed with Croatia and The former Yugoslav Republic of Macedonia. In its first annual report on the Stability Pact, issued on 4 April 2002, the European Commission referred to the "special and inclusive nature of the privileged relationship" between the EU and the south-east European states, and stressed the need to develop regional cooperation.

The great bulk of industrial products from the countries of the western Balkans already enter the EU duty free. The SAAs promise a free trade area with the EU within six years, and also include provisions on the freedom of movement of capital and the liberalization of road transit. In addition, they refer to the "potential candidacy for EU membership". But EU membership is a long-term prospect for most of them, and for the time being their situation is not significantly different from that of the CIS countries.

Given that the countries of the western Balkans can look forward to free trade with the EU within the next few years, is the impact of enlargement a serious issue for them? As far as trade is concerned, the main difficulties are with

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[472] Covering the readmission to Russia of persons residing without authorization in a member state of the EU. The European Union On-Line, *Free Movement of Persons*. *Readmission Agreements* [europa.eu.int/scadplus/leg/en/lvb/l33105.htm].

[473] European Commission, *Communication from the Commission* …, op. cit.

[474] For example, Poland announced that it would introduce visas for Belarusians, Russians and Ukrainians from mid-2003. Statement by Polish Foreign Ministry, 3 April 2002.

[475] One type of FTD will allow for multiple entries and the other will be restricted to single return trips by train. European Commission, *Joint Statement on Transit between the Kaliningrad Region and the Rest of the Russian Federation*, 11 November 2002.

[476] *Federal'naya Tselevaya Programma Razvitiya Kaliningradskoi Oblasti na Period do 2010 goda*, Government of the Russian Federation (Moscow), December 2001.

[477] European Commission, *Communication from the Commission* …, op. cit., p. 3.

[478] The economic relations of Bulgaria and Romania with the EU will be governed by European Agreements until their expected accession in 2007. Imports from the non-acceding countries will be subject to national tariffs until that date.

TABLE 6.1.6

The structure of Slovenian exports, 1999-2001
(Per cent, total=100)

	1999	*2000*	*2001*
European Union	66.1	63.9	62.2
Germany	30.7	27.2	26.2
Italy	13.8	13.6	12.5
France	5.7	7.1	6.9
Bosnia and Herzegovina	4.2	4.3	4.3
Croatia	7.9	7.9	8.6
The former Yugoslav Republic of Macedonia	2.1	1.8	1.4
Yugoslavia	1.0	1.6	2.5
Russian Federation	1.5	2.2	3.0
United States	3.0	3.1	2.6

Source: National statistics; UNECE secretariat calculations.

agriculture and heavy industry. All five western Balkan countries are significant agricultural exporters, including to central Europe and the Baltic states (see annex tables 6.1 and 6.3). On the other hand, they tend to export Mediterranean products that are not heavily protected by the CAP. As for heavy industry, all the countries of the region are significant producers of steel, and Croatia and The former Yugoslav Republic of Macedonia have been targeted by recent EU anti-dumping actions. How the burden of EU contingent protection of heavy industry on the western Balkan countries changes after enlargement is likely to depend on the integration of the steel and other industries of the new member states with the corresponding industrial structures in the existing EU. Overall, however, it seems unlikely that continued restrictions on trade in agricultural and heavy industrial products will impose a significant extra cost on the west Balkan economies upon enlargement.

Potentially more serious are the problems that may be caused by the introduction of the EU visa regime on the Croatian/Slovene border. Some progress has been made in the redevelopment of trading links between Slovenia, the most economically developed part of the former SFR of Yugoslavia, and the other countries of that region (table 6.1.6). Considerations of geography, and of inherited endowments and links, physical and human, suggest that these trade relations will develop further, other things being equal. Once businessmen from the rest of the former SFR of Yugoslavia need EU visas to get into Slovenia, however, things may not be the same, and it is quite possible that, as a result, the recovery of trade within the west Balkan region will be impeded. As is clear from the figures in table 6.1.6, the impact of this on Slovenia will not be huge, but it could be more serious for the weaker, non-acceding economies. If at some point in the future Croatia joins the EU, leaving Bosnia and Herzegovina, The former Yugoslav Republic of Macedonia and Yugoslavia outside, the impact on trade of travel restrictions on the latter countries may increase. In addition, there could be a significant disruption of social and human contacts, particularly along the border between the Dalmatian region of Croatia and Herzegovina, which is predominantly inhabited by Croatians.

(x) The issue of investment

Investment behaviour is one of the biggest unknowns in relation to the impact of enlargement on new member states. In their seminal work on the effects of enlargement on the GDP of the central European countries,[479] Baldwin, Francois and Portes simply assumed that joining the EU would produce a sharp fall in the risk premia on investment in the acceding countries. It is that assumption which lifts their estimate of the enlargement-induced growth bonus from 1.5 per cent to 18.8 per cent. Other authors,[480] have argued that reductions in risk premia are not automatic, and that institutional weaknesses in the acceding countries, notably in the banking system, may conspire to keep risk premia significantly higher than they are in western Europe. The whole issue is complicated by the question of anticipation. Thus, Bevan and Estrin suggest that announcements about accession may have a big effect on FDI flows, but that the effect may be limited to “the psychically close nations, which were frontrunners in the accession process at the time.”[481] It is certainly the case that the great bulk of FDI in eastern Europe and the CIS has gone to central Europe[482] (table 3.5.10 and appendix table B.17), the first group to begin formal negotiations for accession to the EU. But in terms of political stability, technological congruence and social capability,[483] progress in economic reform (including commitment to privatization involving foreign investors) and location, central Europe and the Baltic states are arguably significantly more attractive to international investment than most other east European and CIS economies, irrespective of the issue of EU accession. Of course, these same factors make them more attractive from the point of view of EU accession as well. On balance, it is probably prudent to assume that accession will help to sustain the flows of FDI to the acceding countries, rather than

[479] R. Baldwin, J. Francois and R. Portes, op. cit.

[480] D. Dyker, “The dynamic impact on the central-eastern European economies of accession to the European Union: social capability and technology absorption”, *Europe-Asia Studies,* Vol. 53, No. 7, November 2001, pp. 1001-1021.

[481] A. Bevan and S. Estrin, *The Determinants of Foreign Direct Investment in Transition Economies,* Centre for New and Emerging Markets, London Business School, March 2001, p. 26.

[482] UNECE, “Economic growth and foreign direct investment in the transition economies”, *Economic Survey of Europe, 2001 No. 1*, chap. 5.

[483] For precise definitions of these concepts see D. Dyker, op. cit.

producing a dramatic upward shift in the trend line.[484] It should be borne in mind that the impact of new greenfield investments and follow-up investments (in existing facilities) will be to some extent offset by reduced privatization-related FDI as the stock of state assets is exhausted.

The non-acceding countries have generally attracted much less FDI than the accession countries. But, again, such levels have more to do with the factors mentioned above than with the absence of EU candidate status. In particular, most of the non-acceding countries, especially many of the CIS, have lagged in the processes of economic reform (thus failing to create a suitable investment climate) and privatization.[485] Moreover, many of these countries are disadvantaged by geography,[486] although their rich national resource endowments have often captured the interest of foreign investors.[487] In relation to technological congruence, experience with the automotive industry is particularly noteworthy. Here, international companies have found it as difficult to establish their firm-specific production line and supply network "cultures" in countries such as Russia and Ukraine (with strong engineering traditions) as they have found it easy in central Europe.[488] There is, therefore, a simple and plausible argument to the effect that EU enlargement will not affect the general perception of investment possibilities in the non-acceding countries in any way.

There is, however, a difference between investment possibilities and investment decisions. EU enlargement is likely to improve the perception of the investment possibilities of the acceding countries, although to what exact extent is unclear. Thus, the relative perception of investment possibilities in the non-acceding countries will, other things being equal, worsen. That is only a problem for the non-acceding countries if the total international investment "budget" for the east European and CIS economies is in some way constrained. In that case, there would be a real danger of the non-acceding countries being "crowded out". But there does not appear to be any good reason to believe that such constraints exist, at least to any significant degree. Total investment, whether globally or within particular countries, varies sharply over time and between firms, depending on a whole range of variables, including current profitability, the stage in the business cycle, the state of business confidence, the rate of interest, etc. In the case of the CIS countries, likely future trends in the international price of oil are particularly important for investment decisions, by foreign and domestic firms alike. It is not clear, however, that any of these factors are likely to be significantly affected by enlargement, especially as regards investments in the extraction and transport of natural resources. While, therefore, it would be dangerous to ignore the possibility of crowding out of investment in non-acceding countries, there are no strong a priori reasons for placing special stress on this issue. Finally, it must be noted that, in the case of the CIS countries, WTO accession could do a great deal to improve the perception of investment risk because of the implications of membership for investment and intellectual property rights regulation, technical standards, etc. It is not clear that the combination of WTO accession and EU non-accession would necessarily worsen the relative perception of investment possibilities in the CIS countries.

(xi) Some conclusions

It is difficult to quantify the impact of enlargement on non-acceding countries, and more research is needed on this topic. However, this section has identified some of the key variables determining the impact. Among the points that have emerged are:

- When macroeconomic and liberalization effects are taken into account, the net aggregate impact of EU enlargement on the non-acceding countries is likely to be positive. However, the supply responses in the non-acceding countries, including new investment, and changes in demand patterns in the acceding states will be crucial to the outcome. Most of the CIS countries still have some progress to make to create a favourable investment climate for both domestic and foreign investment, and improvements will require further reform efforts (chapter 5) and the upgrading of infrastructure;

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[484] Buch and Piazolo, on the basis of gravity model analysis, find that the Czech Republic, Hungary and Poland are already close to predicted levels of capital flow assuming EU membership, so that actual accession would not be expected to produce a dramatic increase. For the other seven east European accession countries they find a much bigger gap between actual and predicted levels of capital flow, and therefore forecast a much larger increase in the capital inflow to these countries when accession actually happens. C. Buch and D. Piazolo, "Capital and trade flows in Europe and the impact of enlargement", *Economic Systems,* Vol. 25, No. 3, September 2001, p. 211.

[485] The important roles of economic reform, the pace and scope of privatization and the location of individual transition economies relative to major world markets in determining FDI inflows are discussed in UNECE, "Economic growth …", op. cit.

[486] In particular, the Asian CIS are at great distances from major world markets and primary sea routes (most are landlocked) and generally lack the necessary infrastructure. UNECE, "Economic growth …", op. cit.

[487] The few members of the CIS that have attracted relatively large amounts of FDI have done so on account of their oil and gas reserves (e.g. Azerbaijan and Kazakhstan) or other resources (gold in Kyrgyzstan). The pattern has been less marked in the case of Russia because of various impediments to foreign investment. Ibid.

[488] C. von Hirschhausen and J. Bitzer (eds.), *The Globalization of Industry and Innovation in Eastern Europe* (Cheltenham, Edward Elgar, 2000).

- Cross-border issues are of critical importance to the non-acceding countries on account of the historical peculiarities of border configuration. For that reason visa regimes have an unusually strong bearing on trade issues;
- While there is good reason to be optimistic about the overall impact of enlargement on the economic development of the non-acceding countries, it must be recognized that there are particular problem areas, where the impact could be significantly negative. These include Kaliningrad, and the less developed countries of the western Balkans, and the potential for intensified contingent protection within the expanded EU;
- There are some very specific areas such as energy and energy goods transit which figure prominently in the diplomacy of non-accession, but where the prospects for resolving outstanding problems are relatively good;
- Non-acceding countries, which have not joined the WTO by the time the accession countries have joined the EU, may be faced with special difficulties in relation to trade regimes;
- Recent developments in European economic diplomacy are opening up real scope for the mediation of enlargement impacts on non-acceding countries. The concept of a "Wider Europe" is particularly important in this connection (also see section 6.2(iv)).

6.2 International trade of the CIS

This section reviews the development of CIS trade during the past decade and the evolution of institutions for economic integration within the CIS. Subsection (i) presents an empirical analysis of total CIS trade flows; (ii) focuses on intra-CIS trade, while the expanding trade with non-CIS countries is addressed in (iii); and in (iv) the various regional trading arrangements such as purported CIS-wide free trade agreements, bilateral agreements and other relevant international trade institutions are reviewed and assessed.

The Soviet Union was a large, closed centrally planned economy. The central planning paradigm was incompatible with free foreign trade and currency convertibility as it implied rigid controls over virtually all prices. Under these circumstances, imports were generally seen as a residual source of needed inputs and so exports were required only to the extent necessary to pay for them. As a result of the coordination of plans within the Soviet Union, the former Soviet republics traded mostly with each other.[489] In addition to the requirements of central planning and the poor quality of Soviet products, a number of specific trade restrictions also constrained the country's trade with the rest of the world.[490]

Since the collapse of communism and the subsequent breakup of the country into 15 independent states in the early 1990s, however, the political barriers to trade with the rest of the world have subsided.[491] The international trade of these newly independent states was thus expected to increasingly reflect market forces – instead of central planners' preferences. While a dramatic and swift re-alignment of trade towards the non-CIS countries has occurred (see below), intra-CIS trade in the early 1990s continued to be largely determined by political decisions. At the time, all the CIS countries were in the process of state building and making efforts to assert their newly gained independence. Partly as a result, many protectionist trade restrictions emerged at the national and regional levels. In the most basic form, the newly independent states hoarded goods and, by doing so, attempted to gain leverage in state-to-state negotiations. At a more sophisticated level, trade policies reflected state controls to deal with balance of payments concerns or to maintain low domestic prices of "strategic" goods such as food and fuels. This "inward-looking" strategy lasted until the mid-1990s when the CIS countries began to gradually liberalize their export regimes while, simultaneously, increasing protection against imports. Despite this deliberate shift, which was intended to boast their ailing economies, trade within the CIS region continued to be driven by "policy discretion". In contrast, trade with the rest of the world was subject to more conventional trade policy instruments as extra-CIS exports largely consisted of commodities sales such as natural gas, crude oil and metals.

In the early 1990s, state orders and government trading also featured prominently in intra-CIS trade. These trade arrangements were initially seen as indispensable for stopping the disintegration of economic relationships among the former Soviet republics following the breakdown of central planning and the absence of market supporting institutions

[489] In 1991, only Russia, Turkmenistan and Ukraine shipped more than 10 per cent of the value of their "exports" to non-CIS destinations, and even then this trade was focused on other centrally planned economies. "Trade policy reform in the countries of the former Soviet Union", *IMF Economic Reviews,* No. 2 (Washington, D.C.), February 1994, p. 33, table 1.

[490] Soviet exports were subject to quantitative limits in many countries, while sales of technologically advanced goods to the Soviet Union were prohibited for strategic and security reasons.

[491] This section focuses on the international trade of the CIS countries, that is, all the countries of the former Soviet Union except Estonia, Latvia and Lithuania.

to replace it.[492] Bilateral interstate trade agreements were an essential stopgap measure to secure markets for goods that, in many cases, were not marketable elsewhere.[493] In addition, early in the transition, Russia began to increase the prices for its energy exports towards international levels, an action which promptly led to a reduced import demand by the net energy importers in the CIS and, in many cases, led to large payment arrears. The state-to-state trade agreements aimed to soften such large terms of trade shocks and often ensured supplies of essential raw materials to countries which could not afford to pay at world market prices.

Underdeveloped payments arrangements and malfunctioning monetary and exchange rate systems not only explain the inevitable resort of state orders, government trading, quantitative trade controls and barter but, in addition to the high degree of specialization in the Soviet production system, they also help to explain the abrupt and deep decline in intra-CIS trade following the breakup of the Soviet Union (see below). In summary, the dissolution of the Soviet Union presented the successor states with a major problem. It took several years for state structures and new market supporting institutions to be designed, implemented and enforced. Nevertheless, by 1994, almost all the CIS countries had introduced national currencies. A regional system of payments arrangements and statistical offices also became operational. Consequently, intraregional trade began to recover strongly and, simultaneously, more reliable trade statistics for the CIS became available.

(i) Total trade of the CIS countries

Between 1994 and 2001, the total exports of the CIS countries rose by almost 60 per cent, to $143 billion, while their imports increased by about 30 per cent to $82 billion (chart 6.2.1, top panel). In 2001 these two flows represented 2.4 and 1.3 per cent of world trade, respectively. Russia's trade is dominant, accounting for nearly three quarters of CIS exports and 50 per cent of imports. Moreover, between 1994 and 2001, Russia accounted for almost two thirds of the increase in total CIS exports.[494]

The development of the region's trade since 1994 has been shaped by several factors. Given the importance of natural resources such as crude oil, natural gas, metals, cotton and gold in the total exports of the CIS, global economic cycles – transmitted through fluctuations in commodity prices – have had a significant impact on the value of total exports (although the volume of primary exports has generally increased during this period). In 1998, the Russian financial crisis resulted in a sharp fall in Russian imports, which greatly affected the trade of the other CIS countries. Financial factors have also had a powerful but changing influence on the foreign trade of the CIS countries other than Russia. Many countries ran large current account deficits during the 1990s and much of the growth in their imports was funded by multilateral and bilateral funds, by arrears and in several cases by FDI in mineral extraction projects. However, by the second half of the 1990s, and particularly after the Russian crisis, debt burdens increased and access to new funds diminished, precipitating adjustment and new policy measures to cut imports. In many CIS countries imports fell sharply in 1999 (but not in some of the fuel exporters) and in 2001 they were still below pre-crisis levels.[495] In contrast, Russian imports have rarely been subject to financial constraints but they too remained below the level of 1997. Finally, as noted above, there has been a movement towards a system of trade based increasingly on market forces and comparative advantage, within a framework of trade arrangements among the CIS themselves and with non-CIS partners. However, the impact of these changes on the region's total trade is difficult to assess.[496]

A key feature of the development of CIS trade in the past decade has been the shift from intra-CIS to non-CIS trade. This process had started already in the early 1990s, a period not reflected in the charts presented here and characterized by serious statistical and measurement

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[492] Economic interdependence in the former Soviet Union was very high. In particular, industrial production was integrated across the Union and was coordinated centrally. Moreover, industrial production was highly concentrated. One firm (in one location) often accounted for more than half of the total domestic output of a particular type of product. This was the case in 209 of the 344 aggregate industrial product categories in the Soviet Union. In 109 of these categories, one producer accounted for at least 90 per cent of production. V. Krivogorsky and J. Eichenseher, "Some financial and trade developments in the former Soviet states", *Russian and East European Finance and Trade*, September-October 1996, p. 21.

[493] For more on state trading see C. Michalopoulos and V. Drebentsov, "Observations on state trading in the Russian economy", *Post-Soviet Geography and Economics*, Vol. 38, No. 5, 1997, pp. 264-275.

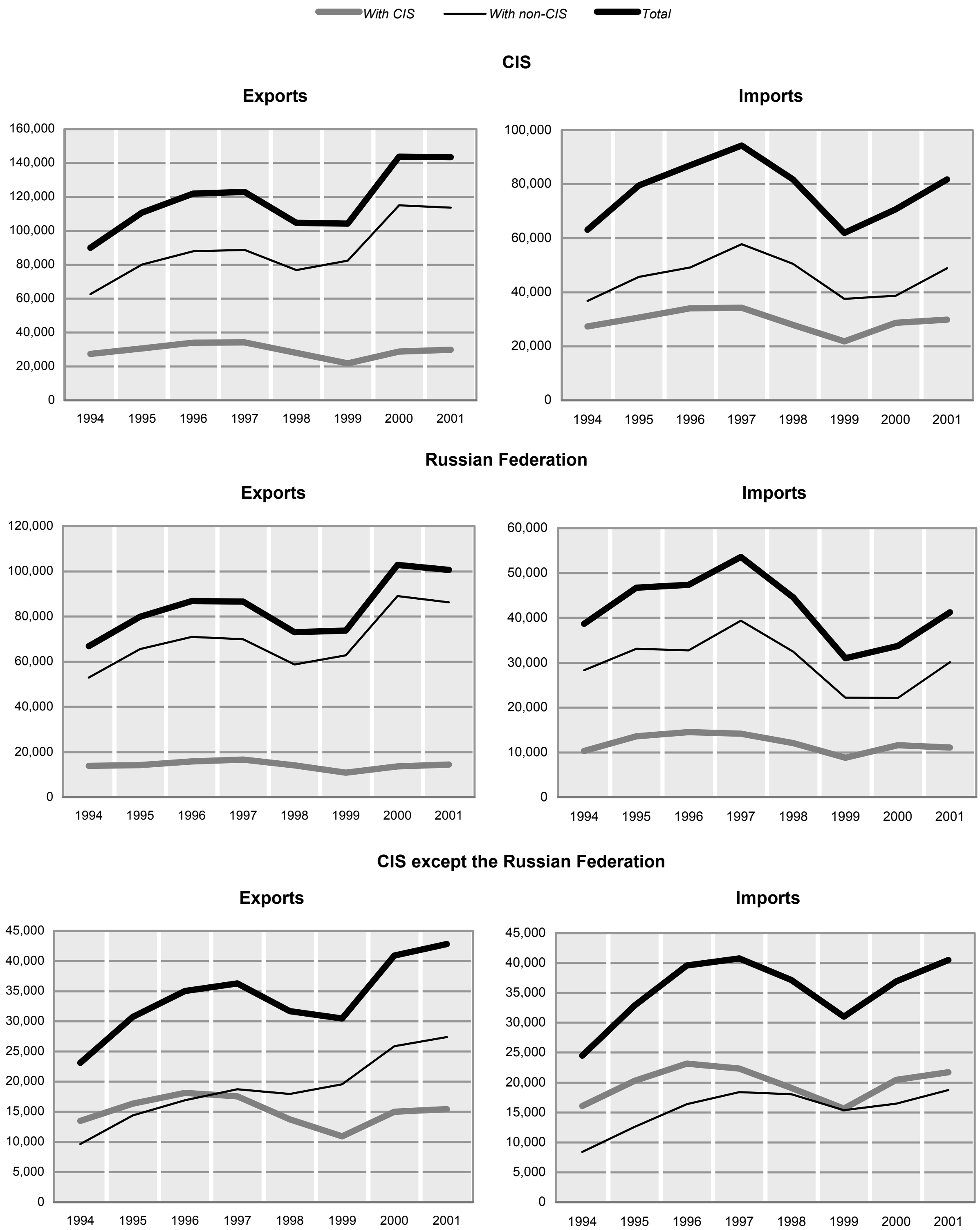
[494] For example, Russia's total exports (chart 6.2.1, middle panel) are very closely correlated with world crude oil prices (with the correlation coefficient of 0.92). While at the beginning of the 1990s, there was a large discrepancy between world commodity prices and intra-CIS prices, currently the great majority of commodity prices in CIS trade reflects world prices. Exceptions are the "administered prices" used in barter trade, which involves, for example, exchanges of Russia's exports of natural gas to Belarus and the Ukraine in return for pipeline transit services.

[495] The increased imports of Azerbaijan, Kazakhstan and Turkmenistan (which explain the recent increase of imports in the lowest panel in chart 6.2.1) are the exception that was made possible by the rapid growth of fuel exports (statistical appendix table B.12).

[496] Early estimates based on gravity models suggested that, in the long run and after market reforms, the share of total trade accounted for by intra-CIS trade should be about 25 per cent. See, for example, M. Lucke, "Accession of the CIS countries to the World Trade Organization", *German Yearbook of International Law*, Vol. 39, 1996, p. 137.

CHART 6.2.1

Trade of CIS countries, 1994-2001
(Million dollars)



Source: Statistical appendix tables B.11 and B.12.

problems.[497] Nevertheless, it is generally accepted that between 1990 and 1994 the share of non-CIS destinations in total CIS exports rose considerably, from about 20 per cent to 70 per cent according to some estimates. This shift was due to the deliberate redirection of exports away from CIS markets against the background of a nearly 90 per cent decline in intra-CIS trade between 1991 and 1993.[498] Trade with the rest of the world declined by much less because many CIS countries – in particular, the natural resource exporters – pursued a policy of selling their products to hard currency areas where payment under normal commercial conditions (and at world prices) was assured. In mutual CIS trade, in contrast, CIS energy importers ran up large trade deficits with energy exporters (Russia, in particular) who in turn were forced to accept barter transactions to clear or reduce payment arrears.[499] The energy exporters' obvious preference for settling transaction without undue delay and in convertible currency as well as the concurrent development of modern payments systems, led to the overall reduction in barter trade. However, in 1997 its use still varied from 2-8 per cent of CIS exports in Georgia, Kazakhstan, Kyrgyzstan, Russia and Turkmenistan; 10-14 per cent in Azerbaijan, the Republic of Moldova and Ukraine; and 28 per cent in Belarus.

(ii) Intra-CIS trade

On average, intra-CIS trade has been sluggish since 1994 (chart 6.2.2 and table 6.2.1). This was due to some of the factors already discussed. Especially important among these was the deliberate strategy of redirecting exports of primary commodities to non-CIS markets. In recent years, this process has been reinforced by foreign direct investment in the commodity producing CIS countries where equity or debt financing is undertaken with a view to developing the export of natural resources to the expanding global markets.[500] Moreover, the sophisticated capital equipment (and services) required for these operations was imported from non-CIS countries rather than from CIS partners, which tend to supply relatively low value added manufactured goods such as pipes.

CIS exports and imports were on an upward trend until the onset of the Russian crisis in 1998. This economic shock, one of the most important factors affecting intra-CIS trade during 1998-2001, was rapidly transmitted throughout the CIS area because Russia was the principal trading partner of many CIS countries. Initially, the fall of the rouble and the subsequent banking crisis led to a temporary breakdown in banking operations, which greatly disrupted imports into Russia.[501] In other CIS countries, the Russian financial crisis, aside from its immediate effects in reducing the demand for CIS goods, triggered a series of currency movements. The movements, in addition to affecting trade in manufacturers to some extent, caused some "traditional" trade flows (especially of foodstuffs and consumer goods) to be redirected, leading to local shortages in exporting countries and a backlash of producers against cheap imports in importing countries.[502] From 1999 economic growth resumed throughout the CIS and in the following year intra-CIS trade picked up. These developments were closely associated with the recovery of domestic production in Russia and with higher commodity prices that lifted the economic performance of commodity exporters such as Azerbaijan, Kazakhstan and Ukraine.

In addition to the stagnant economic performance of the CIS before 1999 and the Russian crisis of 1998, sluggish intra-CIS trade was also a result of non-transparent and protectionist trade policies of CIS countries towards each other. On the one hand, these countries have tried to re-establish their own historic intra-CIS trade links through a variety of

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[497] CIS foreign trade data for the early 1990s are either inaccurate or incomplete due to the evolution of national customs administrations, border controls, payment systems and statistical offices. The available data were also distorted by high inflation rates, barter and non-market or differential exchange rates. Moreover, some countries collected and published information only for selected parts of their foreign trade. For these reasons, the exact value and volume of trade in the early phase of transition may never be known. For more on the statistical problems of international trade in the early 1990s see M. Belkindas and O. Ivanova (eds.), *Foreign Trade Statistics in the USSR and Successor States,* Vol. 18, World Bank, Studies of Economies in Transformation (Washington, D.C.), 1996; M. Belkindas and Y. Dikhanov, "Appendix: Foreign trade statistics in the former Soviet Union", in C. Michalopoulos and D. Tarr (eds.), *Trade in the New Independent States,* Vol. 13, World Bank/UNDP, Studies of Economies in Transformation (Washington, D.C.), 1994, appendix to chap. 1. It should be borne in mind that while the quality of CIS trade data has improved over the past decade, it is likely to be uneven among countries. Most CIS countries have begun to make estimates of informal trade, including smuggling, but the accuracy of these adjustments is uncertain.

[498] Estimates based on market exchange rates. C. Michalopoulos and D. Tarr, "Summary and overview of developments since independence", in C. Michalopoulos and D. Tarr (eds.), *Trade* …, op. cit. During this period, the estimated value of trade of the former Soviet Union countries with the rest of the world declined by 14 per cent.

[499] International barter trade was also used to preserve employment, to maintain trading relationships, to avoid the banking sector and, at times, to conceal transactions and manipulate prices.

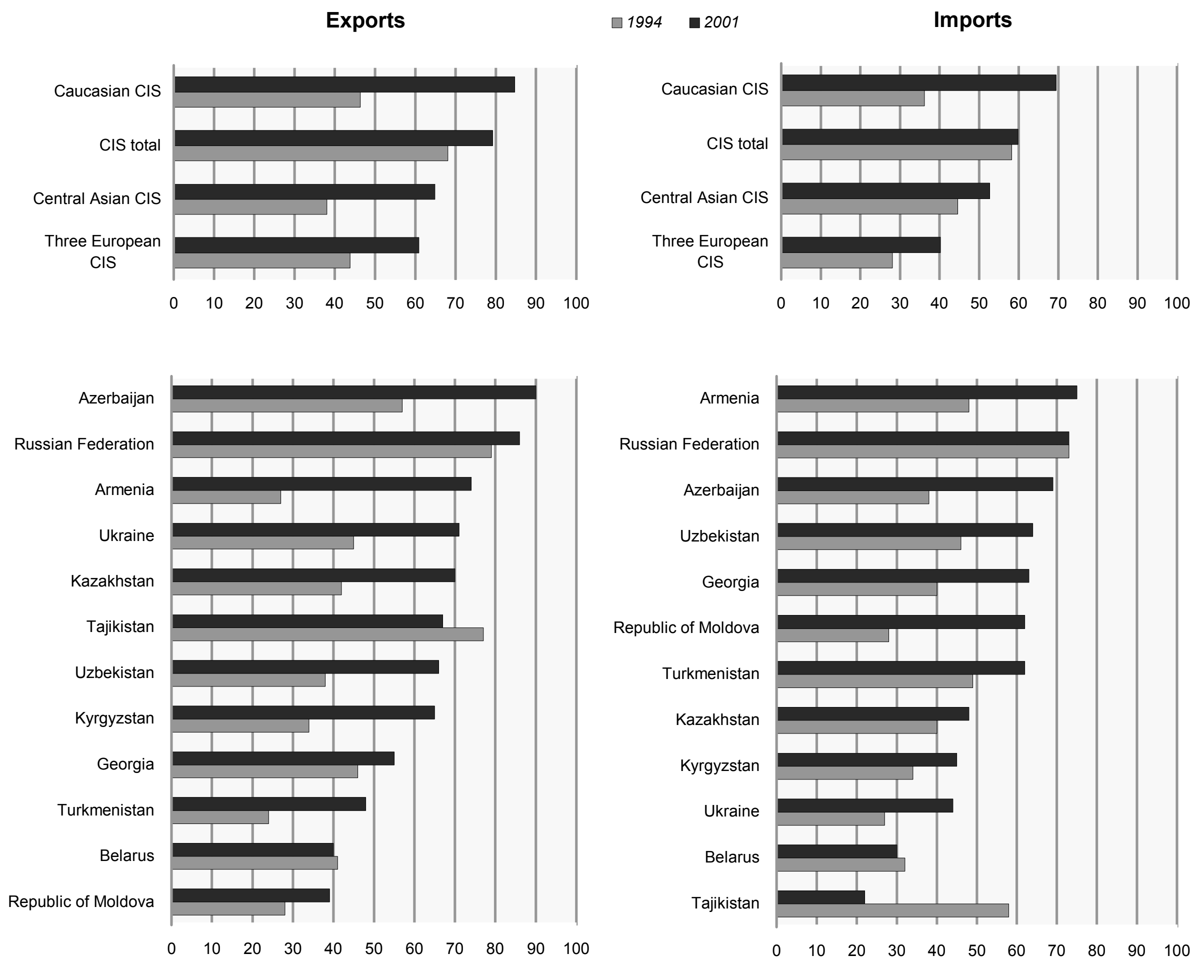
[500] Typical examples are the Kumtor gold mine in Kyrgyzstan and the large, capital-intensive crude oil exploration and development projects in Azerbaijan and Kazakhstan.

[501] In September 1998, for example, intra-CIS exports fell by 46 per cent, year-on-year, but the impact varied by country, ranging from a two-thirds decline in exports from Armenia and the Republic of Moldova to 55 per cent in Ukraine and 40-46 per cent in Azerbaijan, Belarus and Kazakhstan.

[502] The appearance of these regional "trade shocks" resulted in calls for measures to protect domestic enterprises, accusations of trade blockades, and even threats of a trade war in central Asia. For example, in February 1999, Kazakhstan imposed 200 per cent tariffs on selected products from Kyrgyzstan and Uzbekistan, following an earlier ban on imports of Russian food products.

CHART 6.2.2

CIS trade with non-CIS countries, 1994 and 2001
(Shares in per cent)



Source: CIS Statistical Committee, *Statistical Yearbook* (Moscow), various issues.

regional initiatives. On the other hand, the leaders of CIS countries have shown varying degrees of interest in regional economic integration and the creation of a common market. This desire to move towards greater economic integration, however, has resulted in the emergence of a variety of socio-political structures, new customs duties and elaborate trade procedures that clearly have not enhanced trade.[503]

(a) Geographical structure

Russia is the focal point for intra-CIS trade, but intraregional trade flows are not evenly distributed across the CIS. Bilateral trade between Belarus, Kazakhstan and Ukraine on the one hand and Russia on the other is high. Mutual trade among the first three countries is much weaker, but it is still large (except for bilateral trade between Belarus and Kazakhstan) compared with the bilateral trade of other CIS countries (chart 6.2.3). Characteristically, the intensity of the trade of these four economies with other CIS countries is much weaker.[504]

This heavy concentration of trade among the four biggest CIS economies can be attributed to their size, geographical proximity and historical dependence on Russian trade routes. In fact, there has been little change over time in the share of

[503] For more details see sect. 6.2(iv). See also, C. Michalopoulos and D. Tarr, "The economics of Customs Union in the Commonwealth of Independent States", *Post-Soviet Geography and Economics*, Vol. 38, No. 3, 1997, pp. 125-143; J. Lippott, "The Commonwealth of Independent States as an economic and legal community", *German Yearbook of International Law*, Vol. 39, 1996, pp. 334-360; R. Sakwa and M. Webber, "The Commonwealth of Independent States, 1991-1998: stagnation and survival", *Europe-Asia Studies*, May 1999.

[504] Based on exports in 2001, Belarus' and Kazakhstan's sales to both Russia and Ukraine represent, respectively, 98 and 85 per cent of the total value of their CIS exports, while Russian and Ukrainian exports to the other three countries represent 92 and 86 per cent, respectively, of their total CIS exports.

Belarus, Kazakhstan, Russia and Ukraine in intra-CIS trade. Between 1995 and 2001, the trade of these four countries (with each other and with other CIS partners) always accounted for roughly 90 per cent of the total value of intra-CIS trade. Also, the individual country shares – while fluctuating slightly – have hardly changed since 1995. Russia has accounted for half of total CIS exports, Belarus and Ukraine for 15 per cent each, and Kazakhstan for 10 per cent (table 6.2.1).

TABLE 6.2.1

Intra-CIS trade, 1995-2001

(Million dollars, per cent)

	Exports							Imports						
	1995	1996	1997	1998	1999	2000	2001	1995	1996	1997	1998	1999	2000	2001
Millions of dollars														
Armenia	159	128	93	78	55	72	88	329	278	299	230	176	173	219
Azerbaijan	218	290	378	232	211	235	223	228	339	351	405	325	375	445
Belarus	2 930	3 647	5 379	5 160	3 636	4 453	4 472	3 677	4 570	5 806	5 554	4 282	6 001	5 605
Georgia	75	129	138	105	107	136	145	110	270	340	379	225	248	251
Kazakhstan	2 631	3 473	2 850	2 100	1 462	2 391	2 632	2 570	2 963	2 306	2 001	1 595	2 758	3 306
Kyrgyzstan	269	394	319	231	184	207	168	354	487	435	440	259	299	257
Republic of Moldova	467	546	609	429	253	275	347	569	664	604	441	229	262	341
Russian Federation	14 530	15 895	16 624	13 699	10 707	13 824	14 479	13 592	14 549	14 234	11 314	8 343	11 604	11 134
Tajikistan	252	331	273	208	315	374	212	478	383	482	507	514	560	538
Turkmenistan	1 173	1 142	451	152	490	1 300	1 400	628	389	697	478	500	680	850
Ukraine	6 012	7 361	5 586	4 202	3 252	4 497	4 675	7 133	11 106	9 879	7 897	6 743	8 040	8 832
Uzbekistan	1 109	1 150	1 337	793	950	1 140	1 060	1 118	1 118	1 139	869	750	1 050	1 100
Total CIS	29 826	34 485	34 036	27 389	21 622	28 905	29 900	30 784	37 115	36 573	30 515	23 941	32 050	32 877
Percentage shares														
Armenia	1	–	–	–	–	–	–	1	1	1	1	1	1	1
Azerbaijan	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Belarus	10	11	16	19	17	15	15	12	12	16	18	18	19	17
Georgia	–	–	–	–	–	–	–	–	1	1	1	1	1	1
Kazakhstan	9	10	8	8	7	8	9	8	8	6	7	7	9	10
Kyrgyzstan	1	1	1	1	1	1	1	1	1	1	1	1	1	1
Republic of Moldova	2	2	2	2	1	1	1	2	2	2	1	1	1	1
Russian Federation	49	46	49	50	50	48	48	44	39	39	37	35	36	34
Tajikistan	1	1	1	1	1	1	1	2	1	1	2	2	2	2
Turkmenistan	4	3	1	1	2	4	5	2	1	2	2	2	2	3
Ukraine	20	21	16	15	15	16	16	23	30	27	26	28	25	27
Uzbekistan	4	3	4	3	4	4	4	4	3	3	3	3	3	3
Total CIS	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: CIS Statistical Committee, *Statistical Yearbook* (Moscow), various issues.

Another characteristic of intra-CIS trade is the importance of trade with Russia, which is the dominant export destination for almost all CIS countries. From the Russian perspective, however, this trade – excluding Belarus, Kazakhstan and Ukraine – represents a small proportion of the country's CIS imports (13 per cent). Nevertheless, in 2001 there were only three CIS countries – Azerbaijan, Kyrgyzstan and Turkmenistan – which did not ship at least half of the total value of their CIS exports to Russia (table 6.2.2). Exports to Russia account for 66-88 per cent of total CIS exports from Belarus, Kazakhstan and Ukraine, while for Armenia and the Republic of Moldova the proportion is about three quarters.

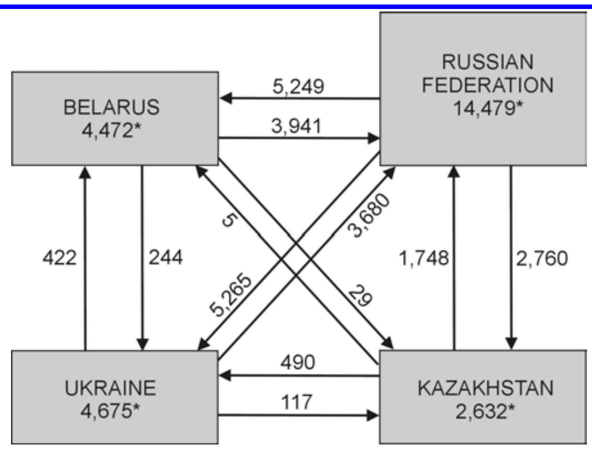
More generally, intra-CIS exports are typically concentrated on a relatively small number of trading partners. Usually, for a CIS country, two or three destinations (including Russia) account for almost all of the total value of its CIS exports. In 2001, for example, there were only three countries – Azerbaijan, Georgia and Turkmenistan – where the top three CIS export destinations did not reach 90 per cent. A similar pattern occurs with intra-CIS imports (table 6.2.3).

(b) Commodity structure

The mutual trade of the four largest CIS economies is heavily centred on Russia, whose demand for CIS food and agricultural products, chemicals, metals and machinery and equipment is almost completely satisfied (between two thirds and almost 100 per cent) by its three largest neighbours (table 6.2.4). These four product categories represent almost three quarters of the total value of Russia's CIS imports. Russia also exports chemicals, metals and machinery

CHART 6.2.3

Bilateral trade flows between the four largest CIS economies, 2001
(Million dollars)



Source: CIS Statistical Committee, *Statistical Yearbook* (Moscow), various issues.

Note: A * denotes total CIS exports.

and equipment to these countries, but the principal products – accounting for almost half of its exports to the CIS – are natural gas and crude oil.[505]

Many other CIS countries also rely predominantly on intraregional exports of commodities such as natural gas, electricity and crude oil. The key energy and fuel exporters – Azerbaijan, Kazakhstan, Russia and Turkmenistan – exploit an abundance of natural gas and crude oil deposits, while Kyrgyzstan and Tajikistan benefit from ample sources of hydroelectric power. The infrastructure inherited from the Soviet-era, such as pipelines, electric grids and hydroelectric power stations, also facilitates commodity exports although, in some cases, it may constrain market diversification. The combined legacies of central planning and comparative advantage also influence trade in agricultural products. Armenia, Georgia, Kyrgyzstan and the Republic of Moldova depend on exports of food and agricultural products (chart 6.2.4). One third of the revenues from CIS exports in Armenia, Georgia and Kyrgyzstan come from sales of agricultural and processed food products while for the Republic of Moldova the proportion is almost 80 per cent.[506] For the non-energy producers energy dominates their intraregional imports. In recent years, for example, energy has represented about half the total value of imports from the CIS into Armenia, Belarus, Georgia, Kyrgyzstan, the Republic of Moldova, Tajikistan and Ukraine. While the central Asian countries are important energy producers they also import fuels and energy from their neighbours owing to the configuration of the pipeline and electricity transmission infrastructure inherited from Soviet times.[507]

Overall, for the largest CIS economies, commodity sales dominate their trade, but machinery and equipment, including transportation equipment is also important. The future prospects for increased CIS trade will depend to a large extent on the ability of CIS economies to produce high quality and price-competitive goods. This, in turn, will depend on increased investment and the upgrading of industrial capacities, supported by the maintenance of a competitive exchange rate. On the demand side, economic growth and thus greater purchasing power by consumers and business in the CIS area is also needed to spur the restructuring of the manufacturing sector. For the smaller – usually agrarian – CIS economies food and beverages are likely to remain important, albeit relatively small in the overall CIS context.

(iii) Trade with non-CIS partners

(a) Changes in geographical structure

As shown, the evolution of CIS trade since the breakup of the USSR has been marked by a strong reorientation from intraregional to extraregional markets (chart 6.2.2). The pace of change, however, slowed considerably in the last few years, and even seems to have come to a halt after the Russian crisis in 1998. In 2001, non-CIS partners accounted for 80 per cent of total CIS exports and 60 per cent of imports, the same shares as in 1999. However, if the Russian Federation is excluded from the aggregate, the export and import shares of non-CIS partners were below their 1999 peak of 65 and 50 per cent, respectively. Whether that is a short-lived phenomenon or a settling in the longer-term pattern remains to be seen. Although many analysts point out that since the collapse of central planning the determinants of trade have changed in these countries, allowing the variables of distance and size to acquire a preponderant influence[508] and

[505] However, in 2001, Kazakhstan was a net energy exporter to Russia because the location of Russian refineries and transport links meant that for some parts of Russia it was easier to get energy from Kazakhstan than from other parts of the country. Such two-way trade in similar products is not uncommon in countries with extensive land borders.

[506] The trade data for the Republic of Moldova do not include the Transdnestria region.

[507] While the data are sometimes inconsistent, in general, Armenia and the Republic of Moldova rely on energy supplies from Russia. Georgia receives energy from Azerbaijan and Russia, while Kyrgyzstan receives energy supplies from Kazakhstan and Uzbekistan. Tajikistan sells and buys electricity to and from the central Asian grid and Azerbaijan buys some energy products from Kazakhstan and Turkmenistan.

[508] In a recent study, S. Djankov and C. Freund showed that the elasticities of trade to income and distance have risen in the former Soviet Union and have come closer to those found in the rest of the world. S. Djankov and C. Freund, "Trade flows in the former Soviet Union, 1987 to 1996", *Journal of Comparative Economics,* Vol. 30, Issue 1, March 2002, pp. 76-90, and "New borders: evidence from the former Soviet Union", *Weltwirtschaftliches Archiv*, Vol. 138, No. 3, September 2002.

thus potentially weakening existing intraregional links, the historical legacy (infrastructure, common language, etc.), produces benefits from sunk costs that may persist, thus leading to levels of intraregional trade that may be higher than predicted by country size and geographical distance factors alone.[509]

Trade with non-CIS partners, which after the initial collapse increased considerably in value from the mid-1990s, albeit with an interruption due to the Russian crisis in 1998-1999 (chart 6.2.1), has also undergone a marked geographical reorientation. For the large initial changes in trade orientation, the figures for the region as a whole are probably more telling, as they can be compared with the relative importance of major trading partners just before the disintegration of the Soviet Union.[510] For the individual countries of the CIS, such comparisons with the period before the breakup are virtually impossible because of the lack of reliable data. (Individual country changes will be analysed below but only from 1995, tables 6.2.5 and 6.2.6.)

[509] See for instance, B. Eichengreen and I. Douglas *The Role of History in Bilateral Trade Flows*, NBER Working Paper, No. 5565 (Cambridge, MA), May 1996.

[510] The direct comparison, however, has to be treated with some caution, as the three Baltic states – a part of the former Soviet Union – are not CIS members, hence they are not included in the CIS aggregate for extra-CIS trade. The bias is probably of limited importance, due to the relatively small size of these countries and their rather restricted engagement in foreign trade during the Soviet period.

TABLE 6.2.2
TABLE 6.2.3

CIS countries' exports to Russia and other main CIS destinations, 1995-2001
CIS countries' imports from Russia and other main CIS sources, 1995-2001
(Per cent)

	Imports from Russia					*Total shares of top sources of imports*	
	1995	*2001*			*2001*	*1995*	*2001*
Armenia	45	69	Georgia / Turkmenistan	39	8	98[a]	96[b]
			Ukraine / Belarus	..	10	..	..
			Ukraine / Turkmenistan	38	13	..	..
Azerbaijan	39	35	Georgia / Turkmenistan	29	30	79[b]	86[a]
			Ukraine	15	..	..	..
Belarus	81	86	Ukraine / Kazakhstan	21	20	92[a]	97[a]
			Ukraine	15	5	96[b]	99[b]
Georgia [c]	44	51	Armenia	16	..	79[b]	71[a]
Georgia [c]	47	36	Azerbaijan	29	29	90[a]	85[a]
			Ukraine / Turkmenistan	17	20	..	..
Kazakhstan	80	67	Ukraine / Turkmenistan	9	19	90[b]	93[b]
			Uzbekistan	10	6	..	..
			Ukraine		5		
Kyrgyzstan	39	38	Kazakhstan	25	23	90..	90..
Kyrgyzstan	32	33	Uzbekistan / Kazakhstan	30	30	89[a]	91[a]
			Uzbekistan	25	26		
Republic of Moldova	77	71	Belarus	6	12	96[b]	99[b]
Republic of Moldova	49	42	Ukraine / Belarus	19	16	98[a]	98[a]
			Ukraine	40	45		
Russian Federation	..	..	Belarus	20	36	87[b]	91[b]
Russian Federation	..	..	Belarus / Kazakhstan	18	39	84[a]	87[a]
			Ukraine / Kazakhstan	20	30	..	..
			Ukraine	49	34		
Tajikistan	38	50	Uzbekistan	53	41	91[a]	91[a]
Tajikistan	28	24	Turkmenistan	12	..	93[a]	69[a]
Turkmenistan [d]	3	19	Ukraine	64		78[b]	65[b]
			Uzbekistan	53	28	..	..
			Armenia	11		..	..
			Kazakhstan	..	17	..	..
			Azerbaijan	..	28	..	..
Turkmenistan [c]	11	28	Armenia / Tajikistan	24	18	87[a]	74[a]
			Ukraine	52	38		
Ukraine	84	79	Belarus	7	5	95[b]	90[b]
			Uzbekistan		8	..	..
			Turkmenistan	4	..	..	..
Ukraine	82	66	Republic of Moldova / Turkmenistan	12	10	94[b]	93[a]
			Kazakhstan		8		
Uzbekistan	50	52	Kazakhstan	20	15	84[b]	91[b]
Uzbekistan [d]	64	56	Kazakhstan / Tajikistan	15	19	84[a]	92[a]
			Ukraine	5	17	..	..

Source: CIS Statistical Committee, *Statistical Yearbook* (Moscow), various issues.
Source: CIS Statistical Committee, *Statistical Yearbook* (Moscow), various issues.
a Cumulative share of top two export destinations.
a Cumulative share of top three sources of imports.
b Cumulative share of top three export destinations.
b Cumulative share of top two sources of imports.
c 1996 instead of 1995.
c 1996 instead of 1995.
d 1998 instead of 2001.
d 1998 instead of 2001.

Of the trade with three regional partner groups (statistical appendix table B.14), that with eastern Europe – that is, the former CMEA partners and the former SFR of Yugoslavia – initially was affected most strongly. The share of these countries collapsed from some 28 per cent of the former USSR foreign trade in 1989 (exports and imports) to 12 per cent of imports and 18 per cent of exports of the aggregate non-CIS trade in 1995 (table 6.2.5). In contrast, the share of the developed market economies, and in particular of the EU, increased from 42 per cent to 56 per cent of exports, but remained at roughly 50 per cent of imports. The share of exports to the developing countries fell slightly, but their share of imports increased from 22 per cent in 1989 to 39 per cent in 1996.[511] Although often overlooked by analysts, this last change may partly reflect the initial delays in industrial restructuring in the CIS economies, as imports from these countries were more likely to consist of consumer goods and semi-manufactures rather than capital goods incorporating new technology.

These initial changes, induced in part by the drastic terms of trade shock, particularly in the case of trade with the east European partners, were partly reversed between 1995 and 2001 but the pattern was not uniform across all the countries (table 6.2.5). In fact, the reversal occurred mainly in the three largest European CIS countries (Belarus, Russia

[511] For a more detailed account of the initial changes in trade of the successor states of the former Soviet Union see, UNECE, *Economic Bulletin for Europe,* Vols. 44-46 (1992-1994) and C. Michalopoulos and G. Tarr (eds.), *Trade* …, op. cit.

and Ukraine) where their fastest growing exports were to eastern Europe and the developing countries.[512] The developing countries also provided the fastest growing export market for Kazakhstan and Tajikistan. Their exports to the developed countries, however, grew less rapidly (or even shrank in Tajikistan) over 1995-2001, although exports to the EU rose strongly, particularly in the last three years. There were no clear-cut patterns in the smaller central Asian and Caucasian rim countries, although for most of them the share of trade with eastern Europe fell to negligible levels, while the markets of their neighbours in the developing world became more important.

Changes in the origin of imports, however, seem to be more uniform. While the initial fall in the importance of eastern Europe continued, the earlier rise in the share of developing countries was reversed in 1995-2001, when imports from the developed economies, notably from the EU and the United States, grew more rapidly. It is to be noted, however, that Russian imports from non-CIS countries fell considerably after Russia's default in August 1998 and had not yet reached their pre-crisis level in 2001 (table 6.2.5 and chart 6.2.1).

TABLE 6.2.4

Commodity structure of Russia's trade with Belarus, Kazakhstan and Ukraine, 2001
(Per cent)

Russia's exports	*Value (million dollars)*	*Share of total*	*Exports to:* Belarus	Kazakh-stan	Ukraine	Total
Mineral products (HS 25-27)	6 359	44	35	10	52	96
Chemicals (HS 28-40)	1 539	11	37	18	20	75
Metals (HS 72-83)	1 563	11	48	24	16	88
Machinery, equipment, transport (HS 84-90)	2 951	20	25	26	35	86
Total above	12 412	86	..	..	..	..
Total exports	14 479	..	..	..	..	..

Russia's imports	*Value (million dollars)*	*Share of total*	*Imports from:* Belarus	Kazakh-stan	Ukraine	Total
Chemicals (HS 28-40)	1 504	14	29	29	40	98
Metals (HS 72-83)	1 609	14	19	12	63	94
Machinery, equipment, transport (HS 84-90)	2 832	25	55	2	18	75
Total above	7 878	71	..	..	..	..
Total exports	11 134	..	..	..	..	..

Source: Russian Federation State Customs Committee, *Tamozhennaya statistika vneshnei torgovli Rossiiskoi Federatsii* (Moscow), 2001. Commodity groups are based on the Harmonized Commodity Description and Coding System (HS).

Changes in the "intensity of trade" with individual regions, an indicator that normalizes changes in trade to take account of the relative importance of the various partners in world trade, point to the continuation of the initial changes in export markets.[513] Table 6.2.6 presents the intensity coefficients for intra-CIS trade and the three major non-CIS export markets. Only with eastern Europe has trade intensity remained substantially higher than unity for the majority of CIS countries in recent years; in other words, each such country trades "more" with the east European region than might have been expected on the basis of the latter's world trade.[514] For the other two partner-regions, a few countries exhibit the same pattern. Moreover, there is a sharp difference in terms of trend: there is a clear and substantial decline in trade intensity with eastern Europe (except for Armenia and Ukraine), in contrast to a general increase (although not uniform) in that with the EU. Trade intensity with developing countries is very diverse, with coefficients above unity in 2001 only for Kazakhstan and Ukraine. The very low trade intensity with partners outside the former CMEA indicates the rather limited openness of several CIS economies towards new markets.

In summarizing changes in the geographical structure of trade in 1995-2001, it is worth distinguishing the European CIS (Belarus, the Republic of Moldova, Russia and Ukraine)[515] from the other CIS countries, as geographical proximity and certain cultural/language links with trading partners appear to have an important influence on trade intensity. In 2001 both groups sold broadly similar shares of their extra-CIS exports to the developed countries (table 6.2.5).[516] However, while European CIS countries are relatively evenly engaged in exporting to east European and developing world markets, non-European CIS countries sell more intensively to the developing world. The European CIS countries tend to have closer links with Europe as a supplier as well, with a much larger share of

[512] Belarus, for instance, still relies on east European markets for nearly half of its extra-CIS exports, while for Russia and Ukraine, they account for about 20 per cent.

[513] For more on the use of the trade intensity coefficient in a similar context see, UNECE, *Economic Bulletin for Europe*, Vol. 48 (1996) as well as earlier issues, Vols. 36 and 37; K. Andersen and H. Norheim, "History, geography and regional economic integration", in K. Anderson and R. Blackhurst (eds.), *Regional Integration and the Global Trading System* (London, Harvester Wheatsheaf, 1993).

[514] As shown in table 6.2.6, trade intensity coefficients for intra-CIS flows remain in double digits. In the case of European CIS countries (except Ukraine), Georgia and Tajikistan, they were actually higher in 2001 than in 1995. This reflects two aspects mentioned earlier in the section: export reorientation from CIS to non-CIS partners in these countries was slower after 1995 (chart 6.2.1), while the CIS weight in world imports diminished considerably after Russia's default; whereas world imports grew 17 per cent in dollar value in 1998-2000, CIS imports fell by 13 per cent and the resumption of import growth in 2001 was not sufficient to offset this slump.

[515] The Republic of Moldova, the smallest and only country in this group that has experienced a continuous decline of exports, exhibited a somewhat different pattern of geographical change during 1995-2001.

[516] A considerably higher share of developed countries in exports of Caucasian rim countries is due mainly to fuel exports from Azerbaijan.

purchases from the EU, and about 15 per cent from other developed countries. On the other hand, non-European CIS purchases from the United States, Japan and other non-EU developed countries account for more than 20 per cent of imports. Both CIS groups import more from developing countries than from eastern Europe, although this tendency is less marked for the European CIS countries. Finally, it is worth noting that non-European CIS countries exhibit a much higher degree of partner concentration, as both import and export shares of non-CIS trade accounted for by the five largest trading partners exceeded 50 per cent, and even neared 80 per cent for Caucasian exports. These shares were well below 50 per cent for the European CIS countries.[517]

(b) Commodity composition

As chart 6.2.5 shows clearly, the CIS countries' extraregional trade is marked by large differences in technology and factor content and mainly consists of interindustry transactions.[518] Fuels and other primary commodities dominate exports, with the EU absorbing the bulk of these, while manufactures with medium to high skill and technology intensity account on average for nearly two thirds of imports, with the EU supplying from under 20 per cent in Turkmenistan to 50-60 per cent in Belarus, Kazakhstan and Russia (chart 6.2.6).[519] As measured by "commodity concentration", all these countries, with the exception of Belarus, are much more specialized in their exports than their counterparts in eastern Europe or the EU,[520] even when fuel exports are excluded. This "excessive" export specialization partly reflects the inherited and well-documented bias of the central planning period against product differentiation and in favour of scale economies. The pattern of export growth in recent years supports this view.

[517] Neighbouring Poland was prominent among the major markets for Belarus and Ukraine, as was Romania for the Republic of Moldova, while Iran and/or Turkey predominated for the non-European CIS countries except Armenia and Kazakhstan.

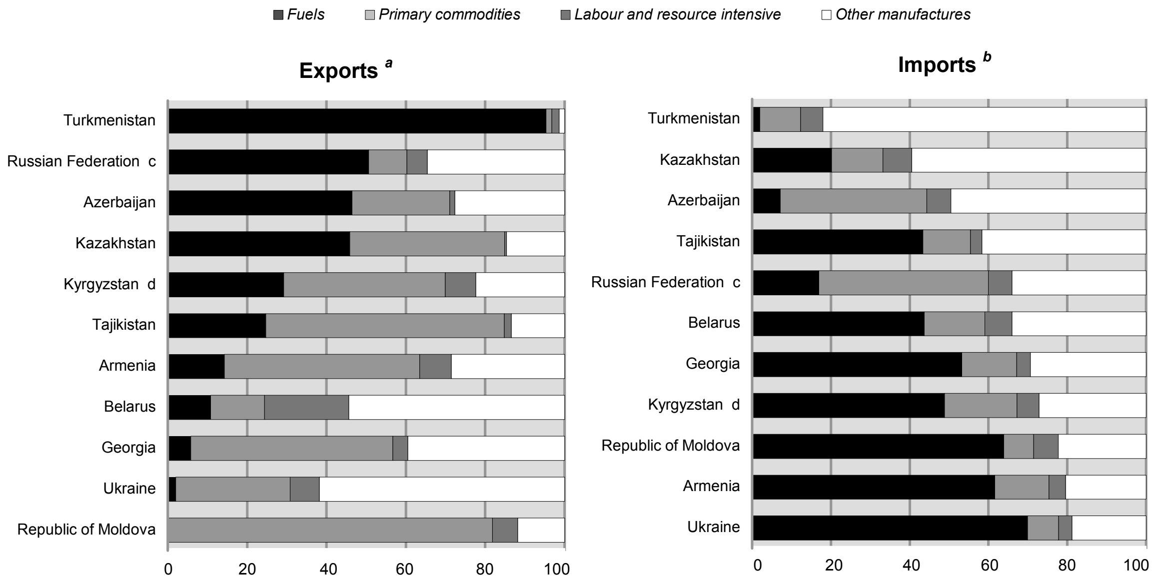
[518] The analysis of the commodity composition of trade relies on United Nations COMTRADE data, which reflect national reporting to the United Nations Statistical Office. Apart from irregularity and delays in reporting, which are characteristic of the majority of CIS countries, two significant issues should be kept in mind in this respect: 1) The Russian Federation, in its reports to the United Nations Statistical Office, lumps *all* trade with Belarus into SITC group 931 "Special transactions and unclassified commodities"; thus, in particular, Russian fuel exports (SITC section 3), which play an important role in this relation, both to the world and to CIS countries, are substantially understated in these data, but other items are of course also affected. Unclassified goods and special transactions (SITC section 9) in Russian trade with the CIS amount on average to some 35-40 per cent of the total in recent years; and 2) In the case of Kyrgyzstan, some two thirds of export value to non-CIS countries is declared as "special transactions" (SITC group 931), although these presumably relate to gold exports.

[519] Above, and in charts 6.2.4-6.2.6, apart from fuels (SITC section 3), non-fuel products (at the 3-digit level of SITC Rev. 2) are reclassified into categories according to the mix of different skill, technology and capital intensities and scale characteristics: primary commodities, labour-intensive and resource-based manufactures, manufactures with low skill and technology intensity, manufactures with medium skill and technology intensity and manufactures with high skill and technology intensity. In the charts the latter three categories are grouped under the heading of "other manufactures". For details of this classification see UNCTAD, *Trade and Development Report, 2002* (United Nations publication, Sales No. E.02.II.D.2), chap. III, annex 1, pp. 87-92.

[520] The reference here is to the Hirschmann concentration index (computed on 3-digit SITC Rev. 3 commodity data) normalized to obtain values from 0 to 1. In the case of CIS countries' total exports in 1999 this index varied from 0.509 in Azerbaijan to 0.250 in the Republic of Moldova and 0.113 in Belarus. In the east European countries it varied from 0.129 in Slovakia to 0.074 in Poland; similar levels were characteristic of the majority of EU countries. UNCTAD, *Handbook of Statistics 2001* (United Nations publication, Sales No. E/F.01.II.D.36), pp. 206-207.

CHART 6.2.4

Commodity composition of trade with CIS partners, 2000
(Shares in per cent)



Source: United Nations COMTRADE Database; for Ukraine data provided by National Statistical Office. Data for Uzbekistan not available.

Note: Commodity grouping is based on three-digit SITC Rev. 2 data; unclassified commodities are excluded. The heading "fuels" refers to SITC section 3 "Mineral fuels, lubricants, etc."; thus it also includes electric current; the heading of "other manufactures" refers to low, medium and high skill- and technology-intensive manufactures (see footnote in section 6.2(iii)(b)).

a Countries are ranked by the importance of fuels in their exports. In the case of Armenia, Kyrgyzstan and Tajikistan "fuels" consist mainly of electric current.

b Countries are ranked by the importance of manufactures in their imports.

c The commodity structure of exports and imports of Russia refers to trade with the 10 CIS countries. A commodity breakdown of trade with Belarus is not available.

d Data for Kyrgyzstan refer to 1999 instead of 2000.

The data for 1995-2001[521] indicate a substantial rise, both in absolute and relative terms, of export revenues from fuel and primary commodities, even after commodity price fluctuations have been taken into account. At the same time, exports of manufactured goods rose only slightly

[521] Until the present, the CIS countries publish detailed commodity data by partners rather inconsistently and often include a substantial portion of trade under unclassified items. In addition, there are no reliable volume or unit value indicators by commodity groups for the majority of these countries. Hence we will complement our analysis below by using mirror data from the major partner group, the EU.

TABLE 6.2.5

Non-CIS trade by destination and source, 1995-2001

(Shares and growth rates in per cent)

	Exports				Imports			
	Structure [a]			Average annual growth	Structure [a]			Average annual growth
	1995	1999	2001	1995-2001	1995	1999	2001	1995-2001
Armenia	100.0	100.0	100.0	16.6	100.0	100.0	100.0	11.6
Developed countries	51.3	74.9	64.8	21.2	61.7	59.7	56.8	10.1
EU-15	47.7	60.4	34.8	10.6	26.1	40.5	38.2	19.0
Eastern Europe	0.4	1.0	0.6	24.6	4.5	3.6	2.4	0.5
Rest of the world	48.3	24.1	34.6	10.3	33.8	36.7	40.8	15.2
Azerbaijan	100.0	100.0	100.0	34.5	100.0	100.0	100.0	14.4
Developed countries	35.1	68.5	82.1	55.0	23.7	52.4	60.4	33.7
EU-15	26.6	59.0	76.9	60.6	19.2	26.8	27.8	21.6
Eastern Europe	2.7	2.4	2.1	29.2	7.5	4.2	4.0	2.9
Rest of the world	62.2	29.1	15.8	7.0	68.8	43.4	35.7	2.6
Belarus	100.0	100.0	100.0	8.9	100.0	100.0	100.0	4.6
Developed countries	36.1	28.2	31.5	6.4	56.5	64.9	59.8	5.6
EU-15	32.4	23.0	27.8	6.1	49.3	55.4	50.6	5.1
Eastern Europe	43.9	37.0	45.6	9.6	33.1	21.7	20.0	-3.8
Rest of the world	20.0	34.8	22.9	11.3	10.5	13.4	20.3	16.8
Georgia	100.0	100.0	100.0	20.7	100.0	100.0	100.0	10.9
Developed countries	12.7	50.1	48.3	50.8	27.0	59.0	54.1	24.5
EU-15	12.7	37.4	32.9	41.5	27.0	35.8	43.4	20.0
Eastern Europe	10.9	3.8	3.7	0.8	26.2	10.6	10.6	-4.6
Rest of the world	76.4	46.2	48.0	11.6	46.8	30.4	35.3	5.8
Kazakhstan	100.0	100.0	100.0	16.8	100.0	100.0	100.0	17.6
Developed countries	59.6	41.5	43.6	10.9	56.4	70.1	68.2	21.4
EU-15	47.1	31.1	33.5	10.3	44.5	44.6	48.9	19.4
Eastern Europe	11.4	7.7	4.4	-0.4	10.3	8.2	6.4	8.8
Rest of the world	29.0	50.8	52.0	28.7	33.4	21.7	25.4	12.3
Kyrgyzstan	100.0	100.0	100.0	14.1	100.0	100.0	100.0	3.7
Developed countries	33.4	75.1	81.4	32.3	41.0	60.0	47.3	6.2
EU-15	27.8	64.0	38.2	20.3	20.2	32.3	26.0	8.2
Eastern Europe	6.7	6.5	3.1	0.4	6.0	3.8	5.0	0.6
Rest of the world	59.9	18.3	15.5	-8.9	53.0	36.2	47.7	1.9
Republic of Moldova	100.0	100.0	100.0	-4.6	100.0	100.0	100.0	12.7
Developed countries	36.1	58.3	68.1	6.0	50.3	54.5	54.3	14.1
EU-15	30.9	48.1	55.0	5.0	42.4	45.4	44.8	13.7
Eastern Europe	55.9	35.7	27.4	-15.3	43.6	37.4	34.2	8.2
Rest of the world	8.0	6.0	4.5	-13.4	6.1	8.1	11.5	25.2
Russian Federation	100.0	100.0	100.0	4.0	100.0	100.0	100.0	-7.1
Developed countries	57.5	55.4	54.1	3.0	47.4	45.6	66.3	-1.8
EU-15	39.2	38.9	43.2	5.7	37.9	34.9	50.3	-2.6
Eastern Europe	17.6	17.3	19.4	5.8	10.8	6.6	10.1	-8.3
Rest of the world	25.0	27.3	26.5	5.1	41.8	47.8	23.7	-15.5
Tajikistan	100.0	100.0	100.0	-2.0	100.0	100.0	100.0	-11.9
Developed countries	82.9	86.6	60.5	-7.0	89.1	75.1	32.1	-25.7
EU-15	69.7	66.3	48.4	-7.8	62.0	56.1	27.7	-23.0
Eastern Europe	10.5	4.3	12.2	0.5	3.8	8.8	15.2	11.0
Rest of the world	6.7	9.1	27.4	24.0	7.1	16.1	52.8	23.0
Turkmenistan [b]	100.0	100.0	..	4.6	100.0	100.0	..	10.2
Developed countries	31.3	30.0	..	11.9	35.7	35.1	..	9.2
EU-15	15.0	19.1	..	24.0	24.3	20.7	..	1.0
Eastern Europe	2.8	2.8	..	-6.2	3.8	2.9	..	22.3
Rest of the world	65.9	67.1	..	0.7	60.6	62.0	..	9.8
Ukraine	100.0	100.0	100.0	13.0	100.0	100.0	100.0	8.7
Developed countries	43.3	43.3	32.6	7.9	59.0	65.1	61.1	9.4
EU-15	25.8	25.4	25.6	12.9	40.4	47.0	48.8	12.2
Eastern Europe	18.0	18.9	21.1	16.1	18.4	20.0	18.4	8.8
Rest of the world	38.7	37.9	46.3	16.4	22.6	14.9	20.5	6.9

(For source and notes see end of table.)

TABLE 6.2.5 (concluded)

Non-CIS trade by destination and source, 1995-2001

(Shares and growth rates in per cent)

	Exports				Imports			
	Structure [a]			Average annual growth	Structure [a]			annual growth
	1995	1999	2001	1995-2001	1995	1999	2001	1995-2001
European CIS (3)	100.0	100.0	100.0	11.7	100.0	100.0	100.0	7.8
Developed countries	41.4	40.3	32.9	7.5	57.9	64.5	60.4	8.5
EU-15	27.6	25.3	26.5	10.9	43.2	49.5	49.0	10.1
Eastern Europe	25.4	23.0	26.1	12.2	23.8	21.3	19.7	4.4
Rest of the world	33.2	36.7	41.0	15.6	18.3	14.2	19.9	9.3
Caucasian CIS (3)	100.0	100.0	100.0	30.5	100.0	100.0	100.0	12.7
Developed countries	35.8	67.2	78.0	48.6	37.2	56.5	57.9	21.4
EU-15	29.2	56.5	69.6	50.8	23.3	33.8	34.3	20.2
Eastern Europe	3.2	2.3	2.1	21.6	10.8	5.4	4.9	-1.3
Rest of the world	61.0	30.5	19.9	8.3	52.0	38.1	37.2	6.6
Central Asian CIS (4) [b]	100.0	100.0	100.0	16.6	100.0	100.0	100.0	10.6
Developed countries	54.8	44.8	46.4	11.9	54.2	59.7	65.4	10.5
EU-15	41.5	33.6	34.7	11.9	39.7	37.3	46.5	7.2
Eastern Europe	9.1	6.8	4.8	-4.6	7.2	6.4	6.7	14.2
Rest of the world	36.1	48.5	48.7	25.5	38.6	33.9	27.9	9.8
CIS total [b]	100.0	100.0	100.0	7.4	100.0	100.0	100.0	-3.2
Developed countries	55.6	52.8	51.3	5.8	48.6	50.4	64.6	-3.1
EU-15	38.1	36.9	41.0	7.9	38.3	37.5	49.0	-4.3
Eastern Europe	17.8	17.2	19.0	9.2	12.1	9.1	11.7	-7.1
Rest of the world	26.6	30.0	29.7	9.4	39.2	40.5	23.8	-2.4

Source: National statistics; United Nations COMTRADE Database; questionnaires.

Note: Aggregates exclude Uzbekistan and, for 2001, Turkmenistan.

a Only for trade with non-CIS partners.

b Average annual growth rate for 1995-2000 instead of 1995-2001.

for the region as a whole, although some countries (the Republic of Moldova, for example) reported large increases in sales of mainly labour-intensive goods. The structure of exports of manufactured goods from the three biggest CIS countries (Kazakhstan, Russia and Ukraine) is consistent with the previously mentioned bias towards products from scale- and resource-intensive industries (non-ferrous metals products, iron and steel, heavy chemicals, pulp, paper and paper products, etc.). A recent study shows that by 2000 Russian and Ukrainian exports to the EU were even more specialized in the metal and metal product sectors. Russia also increased its specialization in chemicals.[522]

In broader terms, the "new" export products[523] that emerged in the CIS countries' trade with the EU between 1995/97 and 2000 represented from 12 per cent (Russia) to 44 per cent (Azerbaijan, Georgia, Uzbekistan) of the total number of exported items on the 5-digit SITC list (table 6.2.7, column A).[524] However, their share in the total value of exports ranged from a meagre 1.1 per cent in Kyrgyzstan to 75 per cent in Azerbaijan (column B). The figure for Azerbaijan reflects mainly recent exports of fuels to the EU; if these were excluded, the "new" products would account for some 24 per cent of total export value in 2000. These large differences in the shares of new products are in fact quite revealing. The ratio of the two shares (table 6.2.7, column B/column A) reflects the relative value of new export items vis-à-vis the average value of all exported items, and is a composite indicator of the scale of restructuring and the degree of product diversification.[525] These (average) ratios are in most cases substantially below unity, as well as in many instances below the relative values of new east European export items in the first five years of transition.[526] The

[522] K. Soos, E. Ivleva and I. Levina, "Russian manufacturing industry in the mirror of its exports to the European Union", *Russian Economic Trends,* No. 3, Russian European Centre for Economic Policy, 2002.

[523] See the note to table 6.2.7 for a definition of "new" exports.

[524] In 2000, the total number of export items at the 5-digit SITC Rev. 3 level (over 3,300 items) varied from 109 in Armenia to 261 in Kazakhstan (among non-European CIS) and from 324 in the Republic of Moldova to 1,803 in the Russian Federation among European CIS. Based on EU import data as reported to the United Nations COMTRADE Database.

[525] UNECE, *Economic Bulletin for Europe*, Vol. 48 (1996), p. 81.

[526] Ibid.

TABLE 6.2.6

Coefficients of trade intensity of CIS countries, 1995 and 2001

	CIS countries		Developed countries		of which: EU		Eastern Europe		Developing countries	
	1995	2001	1995	2001	1995	2001	1995	2001	1995	2001
European CIS										
Belarus	31.98	46.07	0.20	0.20	0.32	0.30	8.07	6.03	0.26	0.28
Republic of Moldova	31.78	47.24	0.20	0.41	0.31	0.56	10.39	3.49	0.10	0.05
Russian Federation	8.92	11.12	0.70	0.73	0.85	0.99	7.20	5.55	0.71	0.70
Ukraine	26.38	21.89	0.31	0.37	0.33	0.49	4.30	5.03	0.64	1.02
Caucasian CIS										
Armenia	31.77	19.51	0.29	0.76	0.47	0.70	0.07	0.15	0.63	0.80
Azerbaijan	22.67	7.33	0.29	1.17	0.39	1.87	0.74	0.64	1.19	0.44
Georgia	31.65	34.39	0.07	0.42	0.13	0.49	2.04	0.68	1.00	0.81
Central Asian CIS										
Kazakhstan	27.83	23.18	0.40	0.48	0.56	0.63	2.56	1.02	0.45	1.12
Kyrgyzstan	33.54	26.95	0.17	0.83	0.25	0.66	1.13	0.68	0.70	0.31
Tajikistan	17.07	24.73	0.82	0.64	1.22	0.88	3.46	2.75	0.15	0.57
Turkmenistan	25.08	..	0.24	..	0.20	..	0.71	..	1.16	..
Uzbekistan	19.96	..	0.50	..	0.47	..	1.48	..	0.84	..
CIS total	13.68	15.37	0.60	0.65	0.73	0.88	6.37	5.08	0.68	0.73
Memorandum item:										
Former USSR in 1990	..	..	0.39	..	0.56	..	27.20	..	1.32	..

Source: WTO and UNECE Common Database.

Note: For country group definitions see table 1.1.3. Calculations based on shares in total exports of each country. The intensity of trade (I) with a given region is defined as: I = xij/mj, where xij is the share of country i's exports going to region j, and mj is the share of region j in world imports.

development of the export of individual "new" products (at the 5-digit SITC level) suggests that it is consistent with the changes in the composition of exports by factor intensity noted earlier.

An increase in exports of labour-intensive manufactures was mainly characteristic of the European CIS countries. These were stimulated by outward processing trade (OPT) transactions with the EU, which have been increasing rapidly in recent years as low wages and a relatively skilled labour force enabled the European CIS countries to compete for such contracts with eastern Europe. According to EU data, EU imports under OPT accounted for 10-18 per cent of total imports from these countries in 1995. In 2001, the share of OPT in the EU's imports from Belarus and the Republic of Moldova increased to 24 and 38 per cent, respectively, and to 12 per cent in the case of Ukraine. In fact, Ukraine became the third most important OPT partner of the EU in the textile sector, accounting for close to 11 per cent of extra-EU imports of these products (the two leading sources were Romania (16 per cent) and Poland (11 per cent)).[527]

The changes in the commodity composition of non-CIS exports point to several potential issues. Their relatively rich endowment of natural resources, characteristic of many CIS countries, is a substantial source of trade in agricultural products and minerals, as well as of industrial products with a high primary commodity content. However, these commodities, together with the products of scale- and resource-intensive industries, such as steel, heavy chemicals, pulp, etc., tend to face relatively high trade barriers and are more exposed to the price fluctuations on the world markets. They also lack market dynamism, as demand for them tends to grow less rapidly than aggregate income, in part because of the general decline in the intensity of consumption and greater efficiency in the use of such raw materials.[528] Also, the advantageous ratio between skill endowments and labour cost, which seems to be recognized by EU partners mainly in the European CIS countries – the proximity factor remains important –may not last very long. OPT usually involves only small amounts of fixed foreign capital, hence its location is highly sensitive to changes in relative labour costs.

The major policy challenge for most of these countries in the near future, therefore, is to develop a more diversified export base that relies less on the vulnerable and volatile primary-commodity sectors and more on skill- and technology-intensive products. While OPT can provide an important short-term stimulus to the employment of domestic resources, long-term solutions will have to be based on institutional restructuring and a sustained search for comparative advantage in high value added activities in industry.

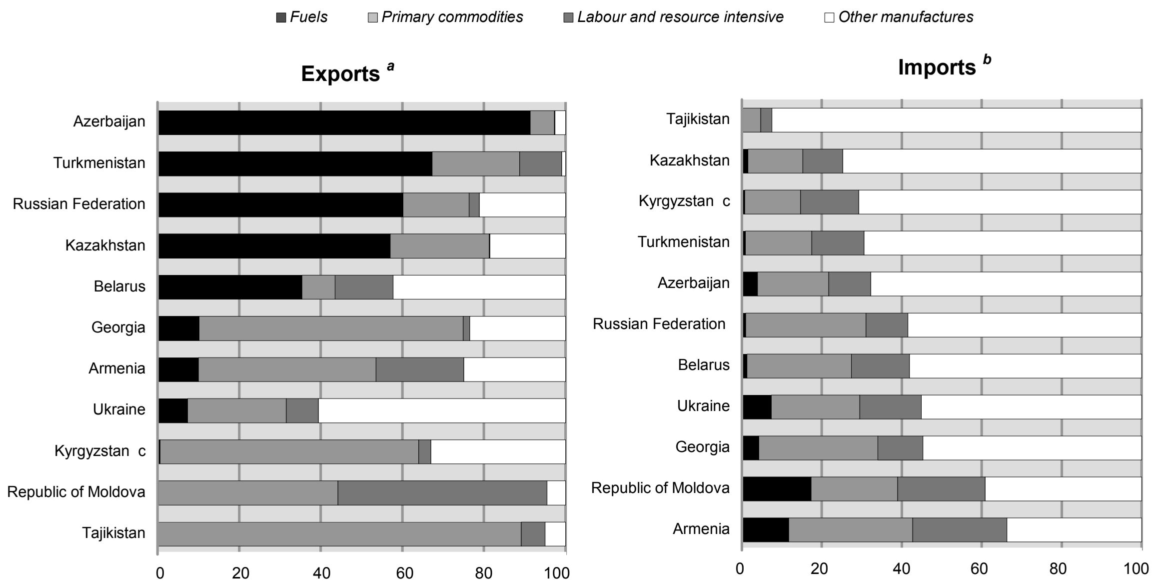
(iv) The evolution of institutions for economic integration within the CIS

[527] European Commission/Eurostat, *Intra- and Extra-EU Trade, Monthly Data*, CD-Rom No. 8, 2002.

[528] UNCTAD, *Trade and Development Report, 2002* (United Nations publication, Sales No. E.02.II.D.2), p. 59.

CHART 6.2.5

Commodity composition of trade with non-CIS partners, 2000 [a]
(Shares in per cent)



Source: United Nations COMTRADE Database; for Ukraine data provided by National Statistical Office. Data for Uzbekistan not available.

Note: See chart 6.2.4

a Countries are ranked by the importance of fuels in their exports.

b Countries are ranked by the importance of manufactures in their imports.

c Based on data for 1999 instead of 2000. Note that in the case of Kyrgyzstan some two thirds of the value of its exports to non-CIS partners is included in the category of "unspecified transactions" (931 of SITC Rev. 2).

(a) The integration agendas of the CIS countries

Under the Soviet system, Russia subsidized all the other republics of the union by supplying oil to them at prices implicit in terms of the counter-flows of other goods to Russia far below world market prices.[529] In the early years of transition, with the rouble zone still in operation, the same pattern persisted or was even amplified. Subsequently, the Russian government followed a policy of reducing Russian trade surpluses with CIS partners, while raising delivery prices towards world levels. Kazakhstan has to a large degree reoriented its hydrocarbon-based industry to the world market, but it remains close to Russia politically. The Belarusian government seems at times to be aiming for total reintegration with Russia, but at other times to be more concerned with asserting its identity vis-à-vis Russia. The central Asian countries vary in their attitudes and policies towards Russia and each other, both among themselves and over time, but, with the exception of Kyrgyzstan, continue to follow highly autarkic economic policies. Uzbekistan has implemented explicitly import-substituting policies throughout its development, as for instance, with cotton processing. Subregional groupings such as CACOM and GUUAM (see below) have yet to develop serious economic agendas, although in some cases this may reflect the general limits of administrative capacity.

(b) Current regional trade agreements

CIS Free Trade Area

The CIS Free Trade Area was originally set up in October 1994, but has not been ratified by a number of CIS states, including Russia (table 6.2.8). It has never worked as a proper free trade area. While the unweighted average

[529] In 1991 the domestic Soviet price for crude oil was 13 per cent of the world level, and for petrol and diesel fuel 9 per cent. L. Artsishevskii and N. Promskii, "Ekonomicheskaya integratsiya stran SNG: problemy i resheniya", *Ekonomist,* No. 9, 2001, p. 52. Because Russia ran "trading" surpluses with most of the other republics in terms of official prices, the true delivery prices of Russian oil and fuel were even lower.

level of tariffs at intra-CIS borders varies from 4 per cent to 30 per cent,[530] import duties do not in themselves represent a major barrier to intra-CIS trade. But VAT has always been a big problem, with Russia generally levying at the point of production and the other countries on the destination principle. Excise duties have given rise to similar problems. Only three countries, Belarus, Kazakhstan and Russia,[531] have resolved this issue as far as their mutual trade is concerned.[532] Russia levies duties on its oil exports to those CIS partners that are not members of the Customs Union (as it does to the rest of the world). Finally, there is a heavy incidence of non-tariff barriers (NTBs) at intra-CIS borders. Overall, only some 60 per cent of Russian trade with CIS countries is actually conducted on a free trade basis.[533]

530 S. Djankov and C. Freund, *Disintegration*, Board of Governors of the Federal Reserve System, International Finance Discussion Papers, No. 618 (Washington, D.C.), August 1998, p. 30.

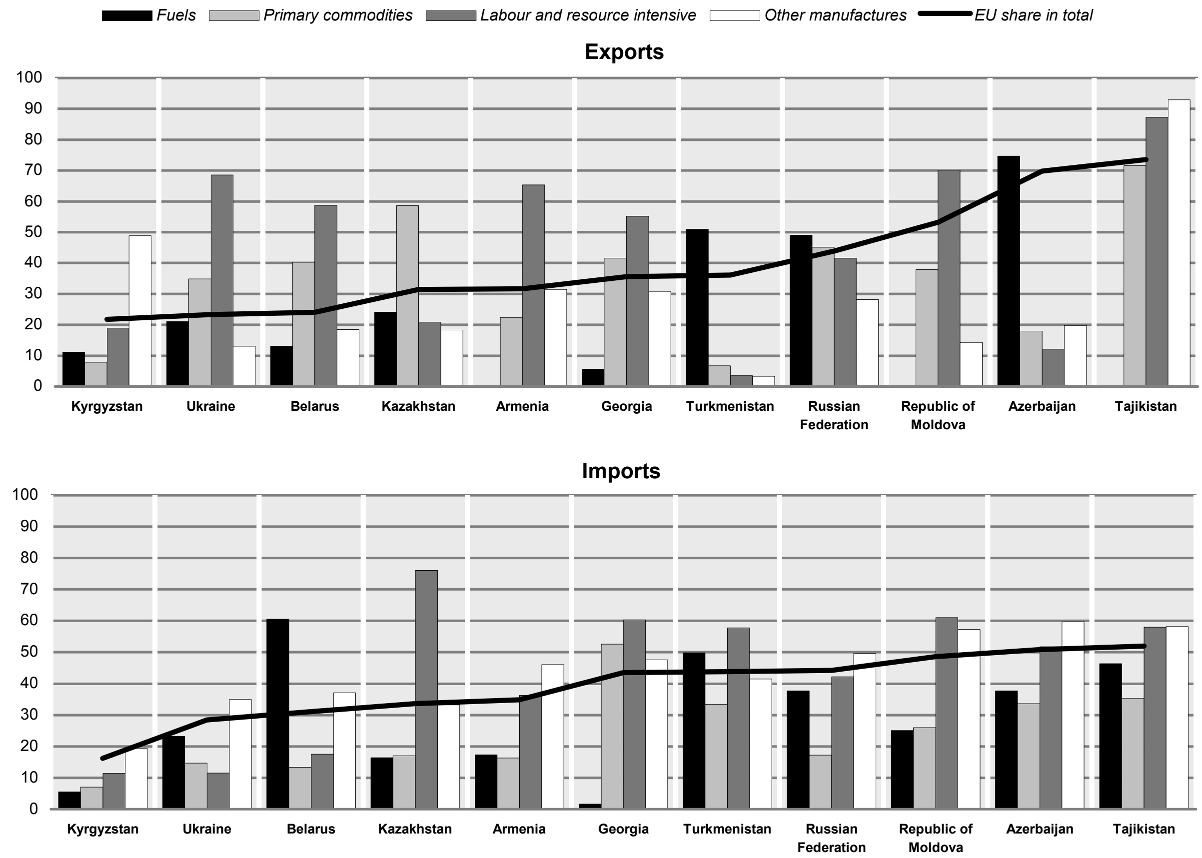
531 The Interstate Council of the Customs Union recommended in October 1999 that the countries of the Union should uniformly adopt the destination principle for mutual trade. The recommendation does not appear, however, to have been systematically implemented. N. Isingarin, "SNG: integratsionno-dezintegratsionnye faktory, stsenarii razvitiya i tendentsiya regionalizatsii", *Rossiiskii Ekonomicheskii Zhurnal,* No. 9 (Moscow), 2001, p. 73.

532 The extent of the problem can be illustrated by the case of Russo-Ukrainian trade. In addition to both being members of the CIS Free Trade Area, Russia and Ukraine have signed a bilateral free trade agreement. The bilateral free trade agreement, however, is a typical CIS free trade agreement, excluding about 200 categories of goods, many of which are among Ukraine's main exports. The dispute between the two countries concerning the collection of VAT and excise duties has a long history. In early 1995, Ukraine stopped charging VAT on its exports to Russia, and in mid-1996 moved fully to the destination principle by starting to charge VAT on imports from Russia. In the same vein, Ukraine stopped charging excise duties on its exports in December 1995. Russia then claimed that imports of Ukrainian alcohol, spirits and sugar had surged as a result of Ukraine's move to the destination principle, and accordingly imposed a VAT of 10-20 per cent on imports from Ukraine (creating a situation whereby Russia was levying VAT on both its exports to and imports from Ukraine), and excise duties on imports of excisable goods from Ukraine equal to those paid by Russian producers of such goods. In addition, Russia threatened to impose import quotas on sugar, alcohol, spirits and light bulbs at levels far below Ukraine's current exports. Following protracted negotiations between the parties, the Russian government agreed not to impose any quantitative restrictions, and to apply price-based protective measures only to the extent that there had been injury to domestic producers.

533 M. Roberts and P. Wehrheim, "Regional trade agreements and WTO accession of CIS countries", *Intereconomics,* Vol. 36, No. 6, November/December 2001, p. 320.

CHART 6.2.6

The share of the EU in total CIS trade with non-CIS countries, by commodity, 2000 [a]
(Per cent)



Source: United Nations COMTRADE Database; for Ukraine data provided by National Statistical Office. Data for Uzbekistan not available.

Note: Commodity grouping is based on three-digit SITC Rev. 2 data; unclassified commodities are excluded. For details on specific categories see UNCTAD, *Trade and Development Report*, *2002*, chap. III, annex 1, pp. 87-92.

a Countries ranked by the importance of the EU in their total non-CIS exports and imports.

TABLE 6.2.7

"New" commodities in CIS exports to the EU, 2000
(Number, per cent)

	Number of "new" items	*Share in total items exported*	*Share in total value of exports (B)*	*Average ratios (B)/(A)*
European CIS [a]				
Belarus	191	26.9	10.5	0.389
Republic of Moldova	122	37.7	15.8	0.419
Russian Federation	225	12.5	2.4	0.193
Ukraine	319	27.0	6.9	0.257
Caucasian CIS [b]				
Armenia	33	30.3	8.5	0.281
Azerbaijan	76	44.4	75.0	1.688
Georgia	265	43.9	43.4	0.987
Central Asian CIS [b]				
Kazakhstan	102	39.1	17.0	0.435
Kyrgyzstan	18	26.5	1.1	0.042
Tajikistan	9	20.0	7.3	0.365
Turkmenistan	51	41.1	42.5	1.032
Uzbekistan	70	44.0	7.3	0.166

Source: United Nations COMTRADE Database.

Note: Calculations are based on data reported by the EU. "New" exports were defined as 5-digit categories of SITC Rev.3, where exports to the EU were $5,000 or less in the beginning of the period, and exceeded $10,000 in 2000.

a New exports since 1995.

b New exports since 1997.

Border formalities at customs offices are often avoided by means of bribes. This adds to the cost of the consignment between 1 per cent (Kyrgyz customs officials being the cheapest) and 6 per cent (in Uzbekistan) on average. Moldovan businessmen report that transit trade through Ukraine and into Russia is subject to a deposit, equal to 100 per cent of the consignment value, at the Moldovan-Ukrainian border. The payment has to be made in Ukrainian currency. Foreigners cannot, however, own Ukrainian currency above certain limits and hence they have to exchange money at the border, and then exchange money back when entering Russia. In the process of exchanging currency, an average of 7 per cent of the value of the consignment is added to costs.

Exporting Moldovan wine to Moscow is more expensive than exporting Australian wine to Moscow, even though the distance travelled is eight times smaller. Similar deposits (at 50 per cent of the consignment's value) are required for Kyrgyz exports through Kazakhstan into

Russia. Kyrgyz businessmen report that in one quarter of the cases they never get the deposit back. In addition, many countries charge foreigners higher rates for rail transport.[534]

A CIS summit in mid-2000 ended with a declaration in favour of trying to make the CIS Free Trade Area more of a reality. Since then, however, virtually no progress has been made.[535] Even if no duties or taxes were levied at intra-CIS borders, it would still be difficult to describe the CIS as a free trade area, because quasi-fiscal barriers often exist within individual countries, reflecting the prevalence of "gate-keeping" behaviour on the part of local political leaders, who often levy local taxes without legislative authority, and of widespread corruption among police forces. Specific commercial and political problems apart, there must be serious doubts about the feasibility of the CIS Free Trade Area, given that "at most, only 5-10 per cent of decisions taken by the CIS supranational bodies are ever implemented".[536]

CACOM/CAEC

At the time of the proclamation of the CIS Free Trade Area, some of the central Asian states (Kazakhstan, Kyrgyzstan and Uzbekistan) had already in January 1994 announced the creation of a "common economic area" (CACOM) based on free trade. This arrangement did not have to contend with the problem of export duties on fuels and energy, but the other problems which have hampered the development of free trade in the CIS as a whole quickly became evident in CACOM as well. CACOM seems to have been somewhat upstaged in 1995 by the creation of the Customs Union (see below). It was renamed the Central Asian Economic Community (CAEC) in 1998 (with Tajikistan becoming a full member after three years of observer status), but this failed to give the initiative any significant new impetus, despite support and encouragement from the western countries. The trend has been for levels of actual trade within the central Asian region to fall steadily since the breakup of the Soviet Union. At present Kazakhstan's trade with its CAEC partners accounts for less than 8 per cent of its total trade with CIS countries.

A CAEC summit held in Dushanbe in June 2000 sought to breath new life into the agreement with the adoption of an economic strategy for the Community to the year 2005 and of a programme of priority measures for creating a single economic space by 2002. This would involve, in the first place, harmonization of customs laws and cooperation in the battle against illegal financial operations. By mid-2002, however, there appeared to have been little progress in this direction. As with the CIS as a whole, the important agreements among central Asian countries are bilateral rather than multilateral. The one notable exception to this is the water management agreement signed between the five central Asian states in 1996[537] – a key development in a part of the world where water is the scarcest resource and the most difficult to manage. The operation of the agreement, however, has not been very effective.

CIS Customs Union

The CIS Customs Union (Belarus, Kazakhstan, Kyrgyzstan, Russia and, from 1998, Tajikistan) was set up in January 1995, or rather the participating countries agreed at that time to start working towards a customs union.[538] The member countries claim to be still working in that direction, and indeed in October 2000, adopting the terminology of the European Union, they proclaimed the Customs Union to be transformed into a Eurasian Economic Community. Ukraine was granted observer status with the Eurasian Economic Community in May 2002, and the Republic of Moldova is expected to follow suit in the near future. The Ukrainian government, however, has made it clear that it does not intend to apply for full membership.[539]

[534] S. Djankov and C. Freund, op. cit., pp. 30-31. In Russia about 200 customs officers are dishonourably discharged every year, and 50-60 found guilty of criminal offences. "Korruptsiya pod pritselom", *Ekonomika i zhizn'*, No. 7 (Moscow), 2000, p. 27. It may be surmised that this is only the tip of the iceberg.

[535] N. Isingarin, loc. cit., p. 71.

[536] M. Roberts and P. Wehrheim, loc. cit., p. 322.

[537] P. Jones Luong and E. Weinthal, "New friends, new fears in central Asia", *Foreign Affairs,* March/April 2002, pp. 61-68.

[538] According to N. Isingarin, loc cit., p. 72, "the term 'customs union' was initially used, not as a description of what had been achieved in terms of integration, but rather as a way of underlining the ultimate goal of the decisions taken".

[539] Statement by Ukrainian prime minister Anatoli Kinakh, *Interfax,* 26 June 2002.

TABLE 6.2.8

The institutions of integration in the CIS

	CIS Free Trade Area	*CACOM/CAEC*	*Customs Union*	*Russia-Belarusian Union*	*GUUAM*
1994	Formation	Formation of CACOM			
1995		Tajikistan admitted to observer status	Formation		
1996		Water-management agreement		Signature of treaty "On the Formation of a Community"	
1997					Formation
1998		Name changed to CAEC; Tajikistan becomes full member	Tajikistan joins		
1999				Signature of treaty "On the Formation of a Union State"	
2000	CIS summit issues declaration in favour of further development	Adoption of an economic strategy for the Community to the year 2005 and of a programme of priority measures for the formation of a single economic space by the year 2002	Transformation into Eurasian Economic Community. Creation of Integration Committee and International Economic Organization	Agreement to create a monetary union	Agreement to set up a free trade area
2001			Start of talks on formation of Transport Union		
2002			Ukraine admitted to observer status. Meetings on coordination of WTO accession negotiations		Summit brings together GUUAM members and all major global powers

Source: Compiled from miscellaneous press reports.

At the present time, however, the CIS Customs Union still cannot claim to be a Customs Union in the textbook sense for eight main reasons:

1) It has no unified external tariff;[540]
2) It has no agreed system of preferences on import tariffs;
3) Russia in particular levies a wide range of export duties on goods going to Customs Union partners;
4) Russia, up to now, has not permitted transit through its territory of goods (in particular hydrocarbons) from Customs Union partners on equal terms with Russian organizations;
5) Levels of tariffs on intra-Customs Union trade are not contractually bound, and there have been a number of cases where member states have imposed penal emergency tariffs on goods coming from fellow-member states, the largest number being in Kazakhstan;
6) The agreement does not exclude anti-dumping measures between partners;
7) There has been no significant progress in harmonizing tax regimes;
8) There is no Customs Union "level playing field". Thus, in August 2002 the Russian government unilaterally deprived non-resident companies of Customs Union tax exemptions.[541]

The Customs Union, however, does maintain in practice a fair approximation to a free trade regime over a wide range of traded goods, and member governments continue to work on the creation of a common tariff.[542] Furthermore, it does have its own decision-taking body (the Integration Committee of the CIS Secretariat), although that body was only founded in mid-2000 after the dissolution of the Russian Ministry for CIS Affairs.[543] The Customs Union has shown itself to be an active organization with some capacity to push integration policy forward. In January 1998, for instance, the member states agreed to implement measures aimed at harmonizing transit conditions throughout the territory of the Customs Union, thus addressing a key point of contention between Russia and her Customs Union partners, and at allowing customs personnel of particular member states to operate throughout the Union for some purposes.[544] By 2001,

[540] N. Isingarin, loc. cit., p. 73, reports that something more than 60 per cent of individual tariffs have been unified for imports from third countries.

[541] Government Decree No. 530.

[542] Ministry of Foreign Affairs of the Russian Federation, Information and Press Department, "Interview of Russian Foreign Ministry spokesman Alexander Yakovenko concerning the forthcoming session of the Interstate Council of the Eurasian Economic Community (EAEC)", *Daily News Bulletin,* 13 May 2002.

[543] The Integration Committee is headed by the prime ministers of the member states and takes decisions on the basis of qualified majority voting.

[544] "Transit – delo nekhitroe", *Ekonomika i zhizn',* No. 30 (Moscow), 2000, p. 27.

the Customs Union partners were working towards the creation of a Transport Union.[545] The customs services of the member states have regular meetings under the aegis of the Integration Committee, although few of the results are public.

A new development is the International Economic Organization (IEO), which was scheduled to start functioning in parallel to the Customs Union from the end of 2000. The role of the IEO is mainly to represent the Customs Union in the world at large, including at the WTO. It will also have responsibility for unifying the Customs Union's external policy. No reports of the activities of the IEO, however, are available and it may not yet have been activated. If the Customs Union does turn into something more recognizable as a free trade area and if all its members want to join the WTO, it will have to notify the WTO and present an argument in favour of exemption from WTO rules under Article 24. The IEO could presumably play a role in this. At mid-2002 the issue of coordinated accession to the WTO was emerging as a key priority for the Customs Union. In August 2002, the Economic Ministers of Belarus, Kazakhstan and Russia, met to discuss the matter, although the meeting does not seem to have produced anything beyond a commitment to the organization of joint training seminars for negotiators and an agreement on the regular exchange of information.[546]

Russia-Belarus Union

The Russia-Belarus Union[547] was created mainly for political and strategic reasons. It is a customs union in the sense that there is a common (Russian) customs service and joint customs and border committees. But there are still customs posts on the Russian-Belarusian border, and the joint Russian-Belarusian customs committee in practice concerns itself primarily with the issue of smuggling.[548] Legislation was passed in early 1998 in Belarus harmonizing most Belarusian tariffs with their Russian counterparts, but the legislation has not been systematically implemented. As a result, the Russian authorities have reimposed some controls on the Belarusian-Russian border, in order to stop Ukrainian companies from using Belarus as a cheap route for exporting to Russia. The issue has also arisen in the opposite direction, with the Belarusian government complaining that its market was being flooded by cheap foreign textiles, coming in through Russia, which levies a lower tariff on textiles than Belarus.[549] A decision by the Central Bank of Russia in February 2000 to increase, unilaterally and without consultation with the Belarus Central Bank, the amount of hard currency residents can take abroad without special permission, introduced a new anomaly in the workings of the Union.[550] Where the Union has made much more progress towards a real customs union is in relation to labour and social security matters, with the right to live, work, study and receive social security benefits anywhere in the Union being guaranteed for all citizens of the Russian Federation and Belarus.[551] There are some 40 joint Russian-Belarusian programmes operating under the aegis of the Union, covering industry, social security and security,[552] and these are empowered to borrow money to finance their activities.[553] There is a Union State budget, adopted annually by the Parliamentary Assembly of the Union of Russia and Belarus.

The Union has also given Belarus specific privileges in its economic relations with Russia. At the beginning of the process of negotiating the union, Russia wrote off Belarusian debts of some $1.5 billion, arising mainly from gas deliveries, and has since continued to extend credits to Belarus. The Russian government has also helped to arrange barter and other deals to cover the unpaid bills. A World Bank study judges that this support from Moscow has been a crucial factor in Belarus's economic stability.[554] By 2000, the Union was looking to press on with the harmonization of taxation and customs duties, and with the establishment of a monetary union. In the event these hopes have been disappointed, and in early 2002 the tax and customs duties regimes of the two countries remained unharmonized. In June 2002, the Russian authorities proposed that the clauses relating to monetary union should be removed from the

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[545] N. Isingarin, loc. cit., p. 73.

[546] Russian Information Agency, *Novosti,* 2 August 2002.

[547] A treaty "On the Formation of a Community" was signed in April 1996, followed by another one a year later, which proclaimed a "Union" between the two states. In December 1999 Russia and Belarus signed a treaty "On the Formation of a Union State". By late 2002, however, the crucial "Union Constitutional Act", which would give the union a proper legal structure on the model of the Treaty of Rome, had still not been adopted.

[548] Russian Information Agency, *Novosti,* 17 June 2002.

[549] C. Rontoyanni, *A Russo-Belarusian "Union-State": A Defensive Response to Western Enlargement,* Economic & Social Research Council, One Europe or Several? Programme, Working Paper 10/00, September 2000, p. 15.

[550] "Pravila vyvoza valyuty v Rossii i Belorussii razlichny", *Ekonomika i zhizn'*, No. 8 (Moscow), 2000, p. 27.

[551] C. Rontoyanni, op. cit., p. 9.

[552] L. Artsishevskii and N. Promskii, loc. cit., p. 55.

[553] *GazetaSNG,* 25 June 2002.

[554] World Bank, *Transition: The First Ten Years, Analysis and Lessons for Eastern Europe and the former Soviet Union* (Washington, D.C., World Bank, 2002).

union treaty.[555] Some two months later, it was proposed instead that monetary union should go ahead, but on condition that there should be only one emission centre for the new currency – in Moscow. This proposal, which would effectively mean the extension of the Russian rouble zone to Belarus rather than the creation of a common currency as such, is not attractive to the Belarusian side.[556]

GUUAM

GUUAM (Georgia, Ukraine, Uzbekistan, Azerbaijan and the Republic of Moldova) is a very loose grouping of southern rim countries, initially set up in 1997 with the main goal of developing hydrocarbon pipeline projects, which would bypass Russia. It has subsequently become more concerned with arms-control issues and with providing a counterweight to the Russian-dominated CIS Collective Security Treaty[557] (Russia plus Armenia, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan).[558] A proposal to create a free trade area was made in 2000 but little progress appears to have been made.[559] However, the issue of hydrocarbon transport remains a matter of concern for many of these countries. The 2002 GUUAM Summit was attended by such outside participants as the United States, the European Union, Russia, most of the CEECs, Iran, Turkey and Brazil, plus a number of international organizations.[560] Clearly, therefore, GUUAM must be regarded as an important element in the complex political economy of southern rim pipeline development. As a force for broader economic integration, however, it remains an extremely weak organization. It has no secretariat, although there are GUUAM national coordinator offices in each member state.

(c) Economic integration in the CIS – the road ahead

Thus the history of attempts to create integrative mechanisms within the CIS has, up to now, been dominated by failure. Perhaps this is not surprising given the diversity of commercial and non-commercial objectives of the CIS countries and a tendency to settle disputes by non-market means. Although the various regional institutions in the CIS have adopted the standard terminology of economic integration, in general they have not effectively performed their necessary roles.

In the case of the Customs Union, some degree of common ground has been found between the causes of political and economic integration. Might it not be possible to build on that common ground, perhaps through some interweaving of regional and global initiatives? An answer to that question first requires a brief review of the existing state of economic integration of the CIS countries with the world at large.

The General Agreement on Tariffs and Trade (GATT) and the associated agreements which are the foundations of the World Trade Organization are based on the principles of most favoured nation (MFN), national treatment of goods, equal treatment for all contracting parties and binding contractual commitments. In sharply limiting arbitrary behaviour in relation to international trade, they therefore address many of the problems that have frustrated the various attempts to develop economic integration within the CIS. Up to now, however, only four CIS countries – Georgia, Kyrgyzstan, the Republic of Moldova[561] and recently Armenia – have actually acceded to the WTO. In joining the WTO ahead of its Customs Union partners (which would have been impossible in a proper customs union), Kyrgyzstan caused considerable disruption in the union as it effectively allowed goods into the area at WTO compliant (and lower) tariff levels. Strictly speaking, this did not break existing Customs Union rules, because they specify that each member will negotiate separately with the WTO. But, at least in the eyes of its partners, it did conflict with the principle that each individual member state should consult its partners before negotiating with the WTO. Kazakhstan took the view that Kyrgyzstan had not consulted enough and imposed emergency tariffs on its imports from Kyrgyzstan, which, again, would not have been possible in a real customs union. But, by the same token, in a real customs union (in the Treaty of Rome sense), Kyrgyzstan would not have been allowed to negotiate separately with the WTO. The real problem here is with the so-called Customs Union, not with the WTO, but it has to be recognized that, under the present institutional framework, WTO membership for just a *few* CIS countries is a negative factor from the point of view of regional integration.

Russia has been negotiating with the WTO since 1993, but the timing of its accession is uncertain. The key problems in these negotiations relate to Russia's relations with the non-CIS world, to its protection of agriculture and

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[555] *RBK*, 21 June 2002.

[556] *GazetaSNG,* 16 August 2002.

[557] An Organization of the Collective Security Treaty was due to be set up in October 2002.

[558] Georgia, the Republic of Moldova and Uzbekistan originally adhered to the Collective Security Treaty, but withdrew in 1999.

[559] N. Isingarin, loc. cit., p. 72.

[560] *GazetaSNG,* 22 July 2002.

[561] UNECE, *Economic Survey of Europe, 1999 No. 1*, pp. 159-162.

financial services, its treatment of foreign investment and intellectual property rights (IPRs) and domestic energy pricing. But until Russia joins, and even if a number of other CIS countries join in the meantime, the impact of the WTO on the CIS trading zone will be limited because so much of the intra-CIS trade of the smaller CIS countries is with Russia. It should be noted that the order of accession to the WTO may be of interest because membership gives some leverage over candidate countries. Thus, while Kyrgyzstan's early accession caused serious problems for it within the Customs Union, it also made it possible for it to sit on Russia's WTO accession working party, which deals with bilateral trade disputes and other issues. It has been suggested that this may be a motive for Ukraine, in particular, to try to complete accession negotiations before Russia.[562] With Russia clearly more concerned with the terms of accession than the speed of accession, such a competitive strategy is unlikely to appeal to the Russian government. WTO membership is at best a necessary, not a sufficient condition for economic integration. What further steps could feasibly be taken?

Universal membership of the WTO will not make the CIS into a free trade area. What it will do is establish the principles of bound commitments and rule-based behaviour within the region. Once those principles have been established, it should be possible to start multilateralizing the trade-related dimensions of the Partnership and Cooperation Agreements,[563] to develop the Energy Charter[564] as a framework for the settlement of disputes and even possibly to use the existing free trade/customs union structures within the CIS as a vehicle for establishing genuine free trade. Going one step further, and on the model of the European Economic Area (EEA), it might be possible to negotiate a multilateral "disarmament agreement" on contingent protection, which would reduce the incidence of anti-dumping and other restrictive actions to a minimum.[565] In this way, it might be possible to build an "enhanced free trade area", which would offer many of the advantages of a common market in a region where, for political reasons, common markets are not yet feasible. For this, however, two key conditions would have to be fulfilled. First, a range of flanking measures would have to be implemented in technical areas such as the trading infrastructure, trade facilitation and the harmonization of standards – there cannot be free trade without efficient and transparent procedures for moving goods from one country to another. The second condition is political will. The history of "integration" in the CIS has been dominated by geo-strategic factors. Why should it be different next time? An optimistic view would set the issue of CIS integration in a global context. The fact that the majority of CIS governments are making progress towards WTO accession is consistent with the reorientation of their trade toward the non-CIS area. Thus, WTO accession in itself may do much to change the perception within the CIS that trade is a zero-sum game. The outcome is not certain, but rapid accession to the WTO by the majority of CIS countries offers the best hope of making progress in the integration of the CIS.

Up to now, discussion of the Common European Economic Space (CEES) has focused on the relationship between the Russian Federation and the EU. That is, indeed, a key relationship within the ECE region, and there is wide scope for rationalizing and liberalizing the economic links between those entities as a condition for the creation of a larger zone of economic integration. The discussion of this section, however, has highlighted an equally important condition, namely that there is no prospect of creating a CEES or, more broadly, a "Wider Europe", until the fundamental problems affecting commercial relations among the CIS countries are solved. The hub-and-spoke pattern is incompatible with the idea of a common economic space. A CIS country, for example, may be a member of the WTO and have a Partnership and Cooperation Agreement with the EU. But if it does not enjoy normal, rule-bound trading relationships with its immediate neighbours, there can be no talk of a common economic space. So, CIS economic integration is not a peripheral, regional issue; it is a necessary condition for the creation of a "Wider Europe". Looked at from the opposite perspective, CIS integration offers a real prospect of driving forward the idea of a "Wider Europe" in those parts of the ECE region where the potential returns to a common commercial governance are greatest.

[562] M. Roberts and P. Wehrheim, loc. cit., p. 318.

[563] Partnership and Cooperation Agreements have been signed between the EU and all CIS countries except Tajikistan. While these agreements are primarily symbols of political goodwill, they do include important clauses in relation to "level playing field" matters such as investment and IPRs. But they are strictly bilateral agreements and their impact, to date, on intra-CIS relations has been negligible.

[564] The Energy Charter, to which every CIS country is a signatory, covers trade in energy carriers, the promotion and protection of investment in energy sectors, and sovereignty issues as they relate to energy. It is based on the MFN principle, and it includes a disputes resolution mechanism. For major energy producers, such as Kazakhstan and Russia, the importance of the Charter lies much more in terms of its relations with the rest of the world (although even here it has not been particularly effective in resolving disputes). Thus, while adoption of the Energy Charter has involved an important commitment to open trade values within the CIS so far, its operational impact has been marginal.

[565] D. Dyker, "Trade policy for the countries of the former Soviet Union (FSU): can the advanced industrial countries help?", *Ritsumeikan Journal of International Relations*, February 2002.

ANNEX TABLE 6.1

Commodity composition of total foreign trade of the non-acceding countries
(Total values in million dollars, shares in per cent)

	Export									
		Shares								
							Other manu-factured goods	*of which:*		*Machinery and transport equipment*
	Total value	*All food items*	*Raw materials*	*Fuels*	*Ores and metals*	*Chemical products*		*steel*	*textiles and clothing*	
Albania										
1999	352	5.5	4.6	2.2	3.9	0.3	77.6	1.4	39.3	5.7
2000	261	6.6	6.0	1.9	3.7	0.6	79.2	3.1	37.6	1.9
Armenia										
1999	232	7.6	3.7	8.3	12.7	0.8	49.9	2.4	5.9	8.7
2000	301	13.5	4.9	10.1	21.4	1.7	24.5	4.3	1.7	15.0
Azerbaijan										
1999	929	6.3	2.8	78.6	3.6	2.5	2.3	0.2	0.5	3.8
2000	1 745	3.2	2.4	85.1	2.9	2.0	0.9	0.1	0.2	3.6
Belarus										
1999	5 909	7.5	3.5	9.1	0.8	15.3	32.3	4.3	10.0	27.3
2000	7 331	6.8	3.6	19.8	0.8	12.9	29.7	3.8	9.1	23.9
Bosnia and Herzegovina										
2000	675	..	..	..	..	..	..	..	..	..
Croatia										
1999	4 303	9.5	4.7	7.8	2.2	11.7	34.9	1.1	14.2	29.1
2000	4 432	8.9	4.5	11.0	3.0	12.2	33.4	1.1	12.6	27.0
Georgia										
1999	238	26.7	3.0	9.9	19.7	9.1	13.9	9.8	0.6	17.8
2000	330	27.6	3.0	8.4	28.4	10.4	9.3	5.2	0.4	12.8
Kazakhstan										
1999	5 592	7.6	1.7	40.9	21.7	6.1	13.6	12.6	0.2	4.9
2000	9 126	6.6	1.3	52.9	19.7	2.5	12.9	12.0	0.1	2.1
Kyrgyzstan										
1999	454		6.0	11.8	5.8	3.3	7.2	0.2	2.0	9.7
2000	505	..	..	..	..	..	..	..	..	..
The former Yugoslav Republic of Macedonia										
1999	1 186	19.1	1.7	1.9	8.7	4.6	54.8	15.3	30.3	7.0
2000	1 319	15.0	1.7	4.8	8.8	4.5	58.6	21.9	26.8	6.3
Republic of Moldova										
1999	464	67.97	2.2	–	2.7	1.6	21.3	–	14.7	4.21
2000	472	61.6	3.1	0.1	1.5	1.8	26.8	0.1	17.8	4.8
Russian Federation [a]										
1999	70 397	1.1	3.8	44.3	12.1	5.5	13.7	6.8	0.9	7.2
2000	96 461	1.3	3.3	54.8	9.8	5.1	12.3	6.4	0.7	6.3
Tajikistan										
2000	784	4.2	12.2	13.3	53.9	1.4	3.6	–	3.4	7.8
Turkmenistan										
1999	1 190	0.5	19.1	64.1	0.7	0.6	9.8	–	9.5	1.6
2000	2 500	0.3	9.9	81.0	0.4	0.4	5.8	–	5.7	0.6
Ukraine										
2000	14 573	9.4	1.7	5.7	14.5	9.2	46.9	4.2	3.8	12.6
Uzbekistan										
2000	3 230	..	..	..	..	..	..	..	..	..
Yugoslavia										
1999	1 493	21.6	4.6	2.5	12.6	9.3	34.3	3.3	9.4	12.2
2000	1 730	17.0	5.7	0.3	15.6	8.5	38.4	6.9	10.0	12.6

(For source and notes see end of table.)

ANNEX TABLE 6.1 (concluded)

Commodity composition of total foreign trade of the non-acceding countries
(Total values in million dollars, shares in per cent)

	Import									
		Shares								
							Other manu-factured goods	*of which:*		*Machinery and transport equipment*
	Total value	*All food items*	*Raw materials*	*Fuels*	*Ores and metals*	*Chemical products*		*steel*	*textiles and clothing*	
Albania										
1999	903	27.4	3.8	3.8	1.1	6.9	39.2	3.0	11.9	17.7
2000	1 070	21.8	0.9	9.1	1.5	6.5	38.5	3.9	10.6	21.6
Armenia										
1999	811	25.78	1.25	21.6	0.6	10.1	25.6	1.28	3.1	13.9
2000	885	25.0	0.9	20.8	0.9	10.5	25.7	0.9	2.5	14.7
Azerbaijan										
1999	1 036	19.7	1.7	6.3	0.9	6.1	23.7	4.2	2.1	41.5
2000	1 172	18.58	1.66	4.92	3.65	7.8	23.8	6.0	2.1	39.7
Belarus										
1999	6 674	12.34	2.68	23	3.48	12.8	23.2	8.8	4.17	20.4
2000	8 574	12.1	2.3	30.6	3.6	11.5	21.6	6.8	3.6	16.7
Bosnia and Herzegovina										
2000	2 290	..	..	..	..	..	..	..	..	..
Croatia										
1999	7 799	8.46	1.36	11.1	2.35	11.7	26.8	2.9	4.9	34.7
	7 887	8.3	1.5	14.6	2.3	12.4	28.3	3.2	6.7	32.6
Georgia										
1999	602	22.55	0.74	23	0.6	10.2	16.4	1.6	2.5	26.4
2000	651	22.6	0.6	21.2	0.7	9.8	18.3	2.1	1.6	26.7
Kazakhstan										
1999	3 687	10.18	0.79	9.4	2.85	9.4	23.1	4.8	1.4	43.8
2000	5 051	9.2	0.9	11.5	3.1	11.4	25.2	7.0	1.2	38.4
Kyrgyzstan										
1999	600	13.6	0.62	20.3	1.4	10.8	22.7	1.54	5.5	30.5
2000	554	..	..	..	..	..	..	..	..	..
The former Yugoslav Republic of Macedonia										
1999	1 773	15.3	2.2	9.2	2.5	10.4	19	2.6	2.7	20
2000	2 085	12.1	1.8	13.8	1.9	9.0	16.5	2.7	1.8	19.6
Republic of Moldova										
1999	587	5.9	1.9	38.9	1.3	8.8	28.2	1.4	10.5	15.0
2000	776	13.1	2.4	32.4	1.1	10.9	26	1.7	9.1	14.1
Russian Federation [a]										
1999	38 626	19.6	1.4	2.1	4.1	7.6	14.5	2.8	1.9	19.6
2000	37 986	18.0	1.9	4.0	5.7	9.8	17.8	3.7	2.4	20.3
Tajikistan										
2000	675	10.2	0.7	37.5	0.1	36.4	5.3	1.0	0.9	9.6
Turkmenistan										
1999	1 500	18.6	0.4	4.1	0.6	9.9	27.3	8.3	2.5	32.7
2000	1 780	11.7	0.4	1.2	1.0	8.4	27.5	8.3	2.9	43.8
Ukraine										
2000	13 956	6.5	1.5	44.2	5.5	9.0	15.2	0.4	3.8	18.0
Uzbekistan										
2000	2 850	..	..	..	..	..	..	..	..	..
Yugoslavia										
1999	3 291	10.3	3.9	17.9	3.7	15.3	26.3	4.4	7.5	21.6
2000	3 721	9.3	3.5	20.1	3.7	15.0	20.8	3.9	3.9	22.1

Source: National statistics; United Nations COMTRADE Database.

Note: Commodity groups based on divisions and groups of SITC Rev. 3 as follows: all food items (SITC 0+1+22+4); agricultural raw materials (SITC 2–22–27–28); fuels (SITC 3); ores and metals (27+28+68); chemical products (SITC 5); other manufactured goods (SITC 6+8–68) of which: steel (SITC 67) and textiles and clothing (SITC 65+84); machinery and transport equipment (SITC 7).

[a] Without trade with Belarus.

ANNEX TABLE 6.2

Commodity composition of trade of the non-acceding countries with the EU
(Total values in million dollars, shares in per cent)

	Export									
		Shares								
							Other manu-factured goods	*of which:*		*Machinery and transport equipment*
	Total value	*All food items*	*Raw materials*	*Fuels*	*Ores and metals*	*Chemical products*		*steel*	*textiles and clothing*	
Albania										
1999	333	5.0	4.1	2.2	3.9	0.2	79.9	1.1	41.1	4.7
2000	243	5.8	5.1	1.4	3.4	0.4	82.5	3.2	39.7	1.5
Armenia										
1999	107	0.5	0.2	–	5.9	0.1	79.3	2.8	1.2	2.0
2000	45	0.6	0.9	–	22.7	0.4	50.7	14.8	1.4	3.6
Azerbaijan										
1999	423	2.1	0.3	93.7	0.9	0.9	1.2	0.1	0.1	0.9
2000	1 054	1.2	–	97.6	0.3	0.3		–	–	0.4
Belarus										
1999	526	1.7	10.9	5.4	1.8	8.2	62.1	4.9	33.3	6.8
2000	689	2.4	9.2	18.8	1.8	9.0	50.8	5.9	25.2	6.1
Bosnia and Herzegovina										
2000	..	..	..	..	..	..	..	..	..	..
Croatia										
1999	2 089	2.8	7.7	4.0	3.3	11.6	52.3	1.3	26.6	18.3
2000	2 416	2.5	6.4	5.6	4.3	10.6	44.0	1.1	21.2	26.6
Georgia										
1999	49	31.6	2.2	0.4	36.0	7.6	13.9	10.5	1.5	8.4
2000	70	33.1	3.2	1.6	39.0	12.8	6.1	2.0	1.0	4.4
Kazakhstan										
1999	1 284	1.5	1.6	15.9	60.7	8.3	3.0	2.4	0.1	1.6
2000	2 073	0.9	0.8	43.5	43.2	3.3	4.9	4.5	–	2.5
Kyrgyzstan										
1999	173	0.4	1.0	–	1.0	4.9	0.7	–	0.2	2.4
2000	..	..	..	..	..	..	..	..	..	..
The former Yugoslav Republic of Macedonia										
1999	540	11.4	1.1	0.2	9.2	0.4	73.4	19.1	48.5	3.9
2000	566	9.0	1.5	0.3	8.7	0.3	75.6	27.4	43.0	4.3
Republic of Moldova										
1999	88	31.15	6.4	–	9.0	0.5	52.5	0.02	47.2	0.51
2000	97	22.9	4.7	–	3.7	0.4	67.7	–	60.1	0.7
Russian Federation										
1999	24 782	0.5	4.0	54.5	17.2	4.2	10.8	3.7	1.3	3.8
2000	36 747	0.7	3.1	65.0	12.4	4.0	8.6	3.4	0.7	3.0
Tajikistan										
2000	218	–	1.6	–	84.5	–	6.8	–	6.8	6.3
Turkmenistan										
1999	134	–	12.4	82.3	2.1	–	3.1	–	3.0	0.1
2000	417	–	3.9	94.9	0.1	–	1.1	–	1.0	–
Ukraine										
2000	2 273	9.5	3.3	6.7	23.3	12.2	38.4	1.7	16.0	6.6
Uzbekistan										
2000	..	..	..	..	..	..	..	..	..	..
Yugoslavia										
1999	545	23.7	6.6	2.9	7.1	4.9	43.4	3.3	17.4	9.8
2000	646	17.3	8.1	–	9.2	3.9	48.1	5.9	17.6	11.8

(For source and notes see end of table.)

ANNEX TABLE 6.2 (concluded)

Commodity composition of trade of the non-acceding countries with the EU
(Total values in million dollars, shares in per cent)

	Import									
		Shares								
								of which:		
	Total value	All food items	Raw materials	Fuels	Ores and metals	Chemical products	Other manu-factured goods	steel	textiles and clothing	Machinery and transport equipment
Albania										
1999	881	26.2	4.05	3.9	1.2	5.7	40.2	2.7	12.9	18.7
2000	810	19.8	1.2	8.2		5.0	41.0	3.3	11.4	22.9
Armenia										
1999	252	18.6	1.6	13.5	0.7		42.8	1.3	1.3	17.2
2000	299	21.0	1.3	12.9	0.4	3.9	35.7	0.8	1.8	23.2
Azerbaijan										
1999	191	7.2	0.3	2.1	0.4	10.0	18.4	3.5	0.5	61.6
2000	227	8.3	0.3	3.2	0.5	10.2	27.6	7.0	0.5	50.0
Belarus										
1999	1 321	745	2.1	1.3	1.6	18.4	35.2	11.9	9.91	33.5
2000	1 290	13.9	2.0	1.1	1.4	20.9	27.1	1.4	9.7	32.8
Bosnia and Herzegovina										
2000	..	..	..	..	..	..	..	..	..	..
Croatia										
1999	4 391	6.6	1.1	1.7	1.8	12.5	30.7	2.6	6.1	40.0
2000	4 368	6.8	1.2	2.1	1.9	13.9	33.6	2.8	9.6	40.5
Georgia										
1999	135	18.5	0.9	1.3	0.6	12	25.2	1.6	3.0	41.6
2000	150	11.4	0.8	2.0	1.2	16.9	24.0	1.5	2.6	43.5
Kazakhstan										
1999	932	5.0	0.8	1.5	0.7	9.0	26.4	3.4	1.2	56.5
2000	1 016	3.5	0.6	1.2	1.1	11.4	25.7	3.8	1.1	55.9
Kyrgyzstan										
1999	110	5.1	0.5	1.4	0.4	10.1	19.7	1.0	1.7	62.9
2000	..	..	..	..	..	..	..	..	..	..
The former Yugoslav Republic of Macedonia										
1999	723	9.4	1.1	7.9	1.5	9.7	14.5	1.0	1.9	27.2
2000	801	8.4	1.1	11.2	1.0	9.4	14.3	1.9	1.4	28.2
Republic of Moldova										
1999	156	5.0	2.7	0.9	1.4	9.7	48.9	0.5	24.5	31.3
2000	226	20.0	4.2	0.6	1.1	8.2	40.9	1.5	21.6	25
Russian Federation										
1999	11 180	18.8	1.3	0.6	1.9	14.1	23.5	3.7	2.4	38.7
2000	11 140	15.9	1.4	0.7	2.0	17.9	25.4	2.7	2.7	35.8
Tajikistan										
2000	29	1.9	–	0.1	0.4	7.5	12.2	0.5	2.7	77.0
Turkmenistan										
1999	202	11.2	0.4	0.2	0.5	8.6	28.5	2.63	0.4	50.6
2000	160	6.3	0.8	0.3	0.2	8.5	22.2	4.5	0.8	61.8
Ukraine										
2000	2 701	7.5	1.8	3.8	2.3	18.3	31.4	0.4	10.7	34.9
Uzbekistan										
2000	..	..	..	..	..	..	..	..	..	..
Yugoslavia										
		7.5	2.1	6.5	1.4	19.7	30.1	2.1	8.9	32.1
2000	1 509	7.4	1.9	5.0	1.9	18.2	24.1	1.9	4.3	34.6

Source: United Nations COMTRADE Database; national statistics for Ukraine.

Note: As for annex table 6.1.

ANNEX TABLE 6.3

Commodity composition of trade of the non-acceding countries with CEFTA-5 and the Baltic states
(Total values in million dollars, shares in per cent)

	Export									
		Shares								
							Other manu-	of which:		Machinery
	Total value	All food items	Raw materials	Fuels	Ores and metals	Chemical products	factured goods	steel	textiles and clothing	and transport equipment
Albania										
1999	2	0.8	14.1	–	27.5	0.7	56.5	48.1	–	0.4
2000	.6	7.0	26.0	–	–	–	58.8	–	–	8.1
Armenia										
1999	.8	55.5	0.5	–	5.5	0.1	37.7	–	–	0.6
2000	1	49.0	–	–	–	3.0	34.0	–	–	13.9
Azerbaijan										
1999	9	52.9	10.9	13.2	7.5	4.9	–	–	–	10.6
2000	22	14.7	56.2	10.4	3.3	10.4	–	–	–	5.1
Belarus										
1999	796	2.6	4.5	42.5	1.7	22.2	15.4	1.4	5.5	11.1
2000	1 355	3.5	3.4	62.7	1.0	15.2	9.7	1.3	3.1	4.5
Bosnia and Herzegovina										
2000	..	..	..	..	..	..	..	..	..	..
Croatia										
1999	581	18.3	4.8	22.7	3.0	16.9	22.3	1.0	3.7	12.1
2000	611	15.8	4.8	27.5	3.2	15.2	22.7	0.8	3.3	10.9
Georgia										
1999	4	55.9	4.2	–	1.9	27.7	10.0	0.7	1.7	0.2
2000	6	37.7	0.3	–	11.3	43.8	2.2	0.2	–	4.7
Kazakhstan										
1999	315	1.8	7.0	46.3	2.6	3.9	34.2	34.1	–	4.2
2000	217	1.7	28.9	43.7	12.2	5.4	7.3	7.3	–	0.8
Kyrgyzstan										
1999	17	30.6	59.3	–	1.3	1.7	0.7	–	0.5	6.3
2000	..	..	..	..	..	..	..	..	..	..
The former Yugoslav Republic of Macedonia										
1999	46	35.3	6.6	1.6	7.8	4.2	21.4	6.8	6.1	23.0
2000	34	31.9	6.6	1.2	11.9	5.2	22.4	7.7	7.0	20.8
Republic of Moldova										
1999	24	69.2	1.0	–	4.8	4.3	17.9	–	13.9	2.67
2000	20	69.3	0.5	–	3.1	2.9	15.9	–	12.1	2.7
Russian Federation										
1999	9 844	0.4	2.7	67.9	6.5	4.5	9.8	2.4	0.7	8.1
2000	15 770	0.5	2.2	73.9	3.6	4.1	8.6	1.7	0.5	7.0
Tajikistan										
2000	26	0.5	91.3	–	0.4	–	7.7	–	7.7	
Turkmenistan										
1999	19	–	78.3	10.1	–	0.1	11.4	–	11.3	0.1
2000	8	–	85.2	0.6	0.5	0.1	13.5	–	13.5	–
Ukraine										
2000	1 474	4.4	7.5	12.9	31.9	10.4	22.3	1.0	2.4	10.6
Uzbekistan										
2000	..	..	..	..	..	..	..	..	..	..
Yugoslavia										
1999	99	11.4	2.1	1.6	10.4	36.6	24.4	1.4	3.6	13.1
2000	114	14.7	6.9	2.0	14.1	19.2	27.0	1.5	6.7	15.7

(For source and notes see end of table.)

ANNEX TABLE 6.3 (concluded)

Commodity composition of trade of the non-acceding countries with CEFTA-5 and the Baltic states
(Total values in million dollars, shares in per cent)

	Import									
		Shares								
							Other manu-factured goods	*of which:*		*Machinery and transport equipment*
	Total value	*All food items*	*Raw materials*	*Fuels*	*Ores and metals*	*Chemical products*		*steel*	*textiles and clothing*	
Albania										
1999	32	52.0	3.7	0.1	0.1	11.6	22.9	1.2	2.5	9.7
2000	33	57.2	0.1	0.1	–	11.0	15.7	0.1	0.5	16.0
Armenia										
1999	10	24.2	0.1	–	0.1	26.8	28.7	2.1	3.5	19.2
2000	8	23.8	–	–	–	35.9	29.9	–	1.7	10.4
Azerbaijan										
1999	20	23.1	0.1	–	0.1	29.6	23.2	–	0.1	23.9
2000	34	16.0	0.1	0.1	–	17.9	16.5	2.2	0.1	49.3
Belarus										
1999	482	25.1	1.0	7.0	1.8	14.3	22.9	0.9	5.1	27.7
2000	533	27.4	0.7	3.2	1.2	15.0	22.8	1.0	4.1	29.6
Bosnia and Herzegovina										
2000	..	..	..	..	..	..	..	..	..	..
Croatia										
1999	1 061	15.4	1.1	2.5	2.5	16.0	41.4	–	4.8	19.4
2000	1 148	15.3	1.9	2.8	2.2	15.5	41.9	7.8	4.4	20.4
Georgia										
1999	15	14.0	0.7	1.9	0.1	52.5	12.3	0.1	1.6	18.6
2000	18	13.2	0.6	0.3	0.1	45.4	22.6	9.8	0.8	17.8
Kazakhstan										
1999	157	19.1	0.1	0.1	4.2	13.5	28.6	0.7	1.0	34.4
2000	160	9.2	0.1	0.1	1.4	21.2	34.7	3.5	0.8	32.9
Kyrgyzstan										
1999	12	7.89	0.1	1.4	0.2	11.4	25.2	5.2	0.6	53.9
2000	..	..	..	..	..	..	..	..	..	..
The former Yugoslav Republic of Macedonia										
1999	216	22.2	1.5	3.5	0.9	18.8	32.8	1.2	2.9	16.5
2000	215	19.2	1.2	3.4	0.7	18.3	30.8	1.3	2.1	18.4
Republic of Moldova										
1999	36	13.6	0.3	15.5	0.9	22.1	39.0		18.5	8.7
2000	54	23.4	0.5	9.3	0.8	20.1	35.4	0.9	10.8	10.5
Russian Federation										
1999	1 783	26.2	1.2	3.1	0.9	19.2	23.0	1.2	2.1	26.0
2000	2 089	20.4	1.1	1.3	2.0	20.4	25.6	1.2	2.5	28.4
Tajikistan										
2000	12	24.9	0.1	1.3	–	35.8	7.0	1.3	0.5	30.9
Turkmenistan										
1999	26	40.39	–	–	–	14.7	21.0	0.7	5.7	24
2000	73	38.4	–	4.8	1.2	11.0	14.4	0.3	0.8	30.2
Ukraine										
2000	1 010	8.5	1.0	19.5	6.1	17.6	28.2	0.4	3.6	19.0
Uzbekistan										
2000	..	..	..	..	..	..	..	..	..	..
Yugoslavia										
1999	289	6.2	2.8	18.4	1.7	17.6	40.6	7.5	5.7	12.4
2000	309	9.4	2.5	8.5	2.4	22.8	35.3	5.6	4.5	16.5

Source: United Nations COMTRADE Database; national statistics for Ukraine.

Note: As for annex table 6.1.