Deepening integration for economic diversification in North and Central Asia

Ongoing economic stagnation in North and Central Asia since the collapse of global oil prices in mid-2014 reinforces the need to diversify the subregion’s economic growth engine beyond the resource-based sectors. Economic growth performance in the subregional economies is often volatile, largely influenced by global prices for a few commodities. For example, oil and gas account for more than 90 per cent of the total export value in Azerbaijan and Turkmenistan and more than half in Kazakhstan and the Russian Federation. Similarly, more than half of Kyrgyzstan’s exports comprise gold, while copper ore and aluminium account for one third of the exports from Armenia and Tajikistan respectively. A more diversified economic base in resource-based economies also would help reduce economic volatility in countries that rely on workers’ remittances, such as Kyrgyzstan and Tajikistan where workers’ remittances (mainly from workers in the Russian Federation) are equivalent to about a quarter of their GDP. Despite an expected modest rebound in the near term, global oil prices are projected to remain relatively low for an extended period of time. In this regard, an effort to broaden the economic base of North and Central Asian economies in order to increase their economic resilience to external adverse shocks remains an urgent task.

The current economic difficulties could undermine the progress made on achieving inclusive development in the subregion. Recent economic recessions have led to slower employment growth, smaller fiscal resources that can be used to support the poor and vulnerable groups, and higher inflation as a result of weak exchange rates. As a result, poverty has increased in such countries as the Russian Federation, with a potentially negative impact on social development in its smaller subregional neighbours. Moreover, income inequality could rise further, as low-skilled workers earning lower pay tend to lose their jobs first.

New multilateral initiatives provide new opportunities for economic diversification

Two emerging multilateral initiatives on trade and connectivity provide a new window of opportunity for economic diversification of North and Central Asia: the Eurasian Economic Union (EAEU) led by the Russian Federation and China’s Belt and Road Initiative.

The Union aspires to become a single market for internal trade among members. Established in January 2015, the pact evolved from the customs union agreed in 2009 between Belarus, Kazakhstan and the Russian Federation. Armenia and Kyrgyzstan also joined EAEU in 2015, while Tajikistan is also considering becoming a member. Parts of the EAEU agreement include abolishing customs controls between member countries, introducing customs procedures in electronic form and harmonizing trade rules. Such trade facilitation measures are expected to help reduce transportation time and trade costs among member countries. Under the customs union, border-crossing time for trucks leaving Kazakhstan for the Russian Federation decreased from almost eight hours in 2011 to less than three hours in 2012.

The trade bloc is also expanding its economic ties to global markets. In October 2016, EAEU ratified its first free trade agreement with Viet Nam, which eliminated trade barriers for the majority of traded goods and enhanced cooperation in such areas as e-commerce, intellectual property protection and public procurement. Moreover, EAEU has already initiated negotiations on possible trade agreements with China, the Islamic Republic of Iran, the Republic of Korea, Singapore and Turkey, among other countries.
In addition to creating a common market in goods, EAEU is evolving into a common market in services, energy and labour. For example, the pact allows service providers registered in a member country to operate in other member countries and permits access to natural monopoly services, such as electricity transmission and energy transport. In the medium term, a common market for electricity is envisaged by 2019 and for petroleum by 2025. The EAEU treaty also provides free movement of labour by eliminating quotas and mandatory work permits and by reducing the number of documents required for migrant workers.

The second emerging multilateral initiative is the Belt and Road Initiative (BRI), which, among other objectives, is aimed at improving infrastructure connectivity between China and Europe through the Eurasian landmass. First announced by China in late 2013, the primary goal of the Initiative is to promote freer flow of economic factors, such as capital, goods, services, energy and people, across Asia and the Pacific and beyond. One core element of BRI is the Silk Road Economic Belt, which comprises land transport routes between China and the rest of Asia and Europe. Of six economic corridors that have been proposed, three pass through North and Central Asia, namely the China-Central Asia-West Asia Corridor, the China-Mongolia-Russia Corridor and the New Eurasian Land Bridge Corridor. These aspects highlight the importance of North and Central Asia in overall BRI strategies.

The efforts to realize a more connected Asia-Pacific region are not new. For example, the project to create a highway network in Asia has been ongoing since 1992. Similarly, several large-scale infrastructure projects that are being planned are also based on facilities that predate BRI, but the Initiative goes beyond improving the network of transport infrastructure. It also seeks to enhance trade, finance, ICT and energy links and strengthen coordination of development policies and strategies across participating countries. What is also striking about BRI is its sheer scale. Most studies suggest that the Initiative could cover more than 60 economies with a collective GDP equivalent to about one third of global output and 40 per cent of global trade, involving a total population of more than 4 billion people.

EAEU and BRI can help facilitate economic diversification and provide impetus for governance reforms

EAEU and BRI are expected to promote economic diversification through at least two channels. The first channel is through enhanced infrastructure connectivity and reduced trade barriers, which can facilitate access to production factors and upgrade participating country’s production capacity. In particular, access to inputs that were not available locally, such as raw materials and technology, can help these economies to increase the variety of goods that they can produce. Even when production factors are already available locally, greater access means that an economy is able to produce goods at more competitive cost, allowing it to participate effectively in global supply chains.

The second channel is through incentivizing Governments to improve their economic governance and push forward policy reforms that can make their economies remain competitive after the opening up of markets. For example, BRI could encourage a race to the top in providing the soft infrastructure essential to make new hard infrastructure productive, such as an enabling business investment in terms of reduced regulatory burden, policy stability and transparent legal framework. Thus, integration would not only help optimize the benefits of economic diversification but also serve as an impetus to governance reforms, producing broader benefits for the economy as a whole.

EAEU and BRI also pose some risks, management of which would entail better governance at the domestic as well as regional levels

While offering many opportunities, EAEU and BRI also present economic and governance challenges to effectively manage regional integration. For example, while EAEU creates a more integrated trade bloc among members, the initiative may hamper trade with non-members because its imposition of a common external tariff and customs code and common external commercial policies, such as anti-dumping duties, discriminates against non-members. This situation could undermine...
overall efforts on economic integration in the subregion. For example, the previous customs union increased the average border-crossing time for trucks entering Kazakhstan from outside the union from less than 9 hours to more than 21 hours.¹

Ensuring the correct balance among governance, economic diversification and inclusive and sustainable development

Governance is also important to enable economic diversification. More than others, resource-rich economies run the risk of rent-seeking behaviours which can encourage economic concentration and act as a brake on diversification. Indeed, economic concentration in North and Central Asia is partly due to this aspect of governance. As a result, the extent to which EAEU and BRI will be able to enhance economic diversification will depend on whether governance is improved.

Greater regional integration can also contribute to improving the quality of economic governance. Membership in multilateral trade initiatives helps countries accept international norms and standards in such areas as intellectual property, consumer protection and transportation. In this regard, the rise in membership of North and Central Asian countries in the World Trade Organization since 2012 is an encouraging sign, as WTO promotes the principles of transparency, evidence-based assessment of trade barriers and due process of dispute resolution. In this regard, EAEU agreements on labour and migration aimed at reducing the number of documents required by migrant workers, increase the time frame for registration and the permissible period of uninterrupted stay, grant social rights to the migrant’s family, especially in education, and provide migrants with guarantees about information availability. These measures are important steps in regularizing labour migration.
