

## 4. Eurasian Economic Union Policies and Practice in Kyrgyzstan

This chapter explores the interplay between the Eurasian Economic Union (EAEU) and the Silk Road Economic Belt (SREB). Richard Ghiasy outlines how Russia and China are cooperating through a ‘forced marriage’ in terms of their regional economic engagement and development models. Damir Esenaliev and Gulzhan Asylbek Kyzy analyse how this interaction is playing out in Kyrgyzstan. They find that misaligned domestic expectations of EAEU membership have provided avenues for enhanced openness to Chinese investment and infrastructure projects.

### 4.1. Richard Ghiasy<sup>1</sup>

#### **Introduction**

The phenomenon of Russia linking its EAEU with China’s SREB stems from a variety of factors.<sup>2</sup> Among the most compelling and instrumental reasons behind this decision is a convergence of the limitations of Russia’s geo-economic scope with its national interests to preserve and promote the EAEU. To better understand these trends, this section examines Russia’s broader geo-economic environment and discusses the drivers of Russia’s decision to pursue EAEU-SREB cooperation, as well as the impact of this cooperation on Asia and Europe.

#### **Russia’s geo-economic scope**

Since the break-up of the Soviet Union, the European Union (EU) and Russia have failed to create adequate formal institutional ties. This has contributed to limiting Russia’s geo-economic space and ‘pushed’ it eastward. The fallout from the crisis in Ukraine means that Russia’s prospects have further diminished.

Russia has observed ongoing economic bloc formation endeavours in all directions. To its west, Russia has witnessed EU efforts to set up the Transatlantic Trade and Investment Partnership (TTIP). To its east, it has been met with the prospect of a Trans-Pacific Partnership (TPP). To its south-east, Russia faces China’s Belt and Road Initiatives (BRI), in particular the land-based portion known as the SREB. Russia has been excluded from all these economic blocs except the BRI.

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<sup>2</sup> For more information see Ghiasy, R. and Zhou, J., ‘The Silk Road Economic Belt: Considering security implications and EU-China cooperation prospects’, Stockholm International Peace Research Institute and Friedrich-Ebert-Stiftung, Feb. 2017, <<https://www.sipri.org/sites/default/files/The-Silk-Road-Economic-Belt.pdf>>, pp. 39–42.

### Drivers of EAEU-SREB cooperation

When analysing the motives behind Russia's decision to endorse the SREB and pursue cooperation between the SREB and the EAEU, nine key drivers stand out. First, linking up the EAEU with the SREB expands the former's international recognition and status. The EAEU had received little external attention until its cooperation with the SREB was declared in May 2015.<sup>3</sup> Second, cooperation with the SREB is both a symbolic and a practical supplement to Russia's 'turn to the East' policy. Third, the SREB's ambition and scope are simply too large for Russia to avoid. Fourth, despite persistent undercurrents of strategic mistrust, cooperation between the EAEU and the SREB paves the way for closer economic collaboration with China.

Fifth, in economic bilateral terms there is a substantial asymmetry between China and Russia, such that negotiations under the SREB and EAEU framework offer Russia an edge. Sixth, the SREB is an important means to bring in much-needed investment capital, which will translate into development projects and could contribute to domestic job creation. When it comes to Central Asia, these trends could help to sustain order and stability in the face of the rising threat of Islamist extremism, instability radiating from Afghanistan and the danger of 'colour revolutions'. The stability of the current regimes in Central Asia is of the utmost importance to Russia.<sup>4</sup>

Seventh, cooperation with the SREB undermines the relevance of US aid and integration efforts in Central Asia, which bypass Russia and weaken its position vis-à-vis these states. Eighth, it is anticipated that the interplay between the SREB and the EAEU will strike a balance between globalism and regionalism.<sup>5</sup> The SREB offers international connectivity, while the EAEU provides a regional market focus. The merger of the two could provide a balance for the Central Asian states in terms of regional and global integration. Finally, ninth, Russia considers the SREB to be a mechanism that further facilitates the transit of Central Asian energy resources to China, thereby increasing the EU's dependence on Russian energy.

Despite this wide range of drivers, it should be noted that the envisaged cooperation between the EAEU and the SREB is something of a 'forced marriage'. While senior political approval is in place, the actual avenues for cooperation barely exist. Russia and China are seeking practical projects for joint work, but setting the framework and the conditions for Chinese investment in Russia through the SREB is still under discussion. These negotiations are likely to take time. Furthermore, international observers highlight the two entities' diametrically oppo-

<sup>3</sup> *Russia Today*, 'Russia, China agree to integrate Eurasian Union, Silk Road, sign deals', 8 May 2015, <<http://www.rt.com/business/256877-russia-china-deals-cooperation/>>.

<sup>4</sup> Bordachev, T., [Russia and China in Central Asia: the great win-win game], *Russia in Global Affairs*, 1 July 2016, <<http://www.globalaffairs.ru/valday/Rossiya-i-Kitai-v-Tcentralnoi-Azii-bolshaya-igra-s-pozitivnoi-summoi-18258>> (in Russian); and Vorobyev, V., [Docking on the strategic orbit], *Russia in Global Affairs*, 8 Sep. 2016, <<http://www.globalaffairs.ru/number/Stykovka-na-strategicheskoi-orbite-18347>> (in Russian).

<sup>5</sup> Safranchuk, I., [When stakes have failed], *Russia in Global Affairs*, 25 Sep. 2016, <<http://www.globalaffairs.ru/number/Esli-stavki-ne-sygrali-18390>> (in Russian).

site institutional designs.<sup>6</sup> How this intended cooperation dynamic will play out, therefore, remains to be seen. The constraining impact of the EAEU's exclusive nature and limited internal and external trade should also not be underestimated. Internal EAEU trade is of little significance to Russia, while total EAEU trade with third countries constitutes only 3.7 per cent of global exports and only 2.3 per cent of global imports.<sup>7</sup>

### Takeaways

Cooperation between the EAEU and the SREB adds to the perceived legitimacy of both initiatives and could help to achieve their respective objectives. To Central Asian states, their cooperation has the advantage that it largely avoids the need to choose between the two initiatives. Moreover, their integration has the potential to strike a balance between regionalism and globalism. To the EU, or rather to the West, this cooperation might contribute to the erosion of its ability to continue to set the 'rules of the game' in economics, trade and investment standards, particularly in Asia. It also limits the EU's opportunities to exploit Russia–China economic divisions to its advantage.

## 4.2. Damir Esenaliev and Gulzhan Asylbek Kyzy<sup>8</sup>

### Introduction

Kyrgyzstan's experience as a member of Eurasian Economic Union from mid-2015 to late 2016 has been largely frustrating. While favourable employment conditions have been created for Kyrgyz labour migrants, the anticipated increased access to the markets of the EAEU member states and large-scale capital investments are yet to materialize. The prospects for Kyrgyzstan's membership of the EAEU may become more favourable in the short term, but this depends on whether the EAEU functions as envisaged. Kyrgyzstan's membership of the EAEU will serve as a testing ground to explore the grouping's effectiveness and scope for future expansion, as well as the capacity of the Kyrgyz Government to navigate this multilateral structure.

While facing EAEU inefficiencies, China has become the primary creditor of Kyrgyzstan in recent years. Even though imports and subsequent re-export opportunities have diminished, China's role in funding large-scale infrastructure projects through direct lending to the Kyrgyz Government, as well as foreign direct investment (FDI) and regional initiatives, is expected to increase in importance.

<sup>6</sup> Cooley, A., *The Emerging Political Economy of OBOR: The Challenges of Promoting Connectivity in Central Asia and Beyond* (Centre for Strategic and International Studies: Washington, DC, Oct. 2016).

<sup>7</sup> See the statistics on the official Eurasian Economic Union website, <[www.eaeunion.org/?lang=en#about](http://www.eaeunion.org/?lang=en#about)>.

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## Kyrgyzstan before and after joining the EAEU

After becoming a member of the World Trade Organization (WTO) in 1998, Kyrgyzstan adopted a liberal trade regime. This gave it the ability to benefit from massive re-exports of Chinese goods to neighbouring countries and Russia.<sup>9</sup> Within this framework, the trade sector became a driver of economic growth and a source of employment for about 15 per cent of the Kyrgyz labour force. Following its decision to join the EAEU, however, it became clear that this re-export activity would cease, given the anticipated end of the differential in import tariffs.

Initially, there was some opposition to joining the EAEU within Kyrgyzstan, particularly from some officials, business organizations and non-governmental organizations (NGOs). They argued that membership would make Kyrgyzstan dependent on Russia not only economically, but also politically.<sup>10</sup> Despite these misgivings, President Almazbek Atambaev and the Kyrgyz Government signed the EAEU membership agreement in May 2015. Kyrgyz officials argued that joining the EAEU was not only the only viable option, but also a highly promising avenue for development.<sup>11</sup> In this way, they raised public expectations too high.

On accession to the EAEU, Kyrgyzstan became the fifth member along with Armenia, Belarus, Kazakhstan and Russia. However, this coincided with a sharp decline in oil prices and the imposition of economic sanctions on Russia, which contributed to the depreciation of the Kyrgyz currency and the contraction of its economy. These events affected Kyrgyzstan's trade, remittances and investment inflows.

## Currency appreciation and depreciation

The less discussed feature of this period is the appreciation of the Kyrgyz Som against both the Russian Rouble and the Kazakh Tenge, which induced an increase in imports of goods from EAEU member states. Kazakhstan's Central Bank depreciated the Tenge to maintain its previous parity with the Rouble, but the Kyrgyz National Bank did not follow suit. It intervened heavily to keep the national currency strong for fear of harming its highly dollarized economy.

Therefore, instead of exporting its agricultural products, Kyrgyz producers suddenly faced competition from Kazakh, Russian and Belorussian companies in its domestic market. This created public disillusionment with the Kyrgyzstan Government's decision to join the EAEU, even though the exchange rate developments were not directly connected to integration efforts. These negative sentiments have intensified with the continued struggles of agricultural exporters, whose exports have been banned by both Kazakh and Russian regulatory bodies

<sup>9</sup> Mogilevskii, R., 'Re-export activities in Kyrgyzstan: issues and prospects', Working Paper 9, Institute of Public Policy and Administration, University of Central Asia, 2012.

<sup>10</sup> Sarabekov, Z., [The EAEU for Kyrgyzstan: A difficult choice] *Institute of Asian Studies*, vol. 3, no. 97 (Aug. 2015), <<http://www.asiakz.com/eaes-dlya-kyrgyzstana-slozhnyy-vybor>> (in Russian).

<sup>11</sup> Putz, C., 'Kyrgyzstan gripes about EEU access', *The Diplomat*, 18 Nov. 2016, <<http://thediplomat.com/2016/11/kyrgyzstan-gripes-about-eeu-access>>.

on the grounds of food quality and safety.<sup>12</sup> A further frustration is Russia's inability to continue with the construction of a hydroelectric station, which resulted in the termination of the agreement. In all these cases, the reality has not lived up to the expectations.

Among the more positive developments, labour migration statistics show that as of 2016, more than 25 per cent of Kyrgyzstan's total workforce was employed in Russia.<sup>13</sup> Remittances account for 30 per cent of Kyrgyzstan's total gross domestic product, and over 90 per cent come from Russia. Between 2015 and 2016, the inflow of remittances increased by 22 per cent to USD \$1.6 billion.<sup>14</sup> These figures contrast with Uzbekistan and Tajikistan, which have witnessed a reduction in the number of labour migrants in Russia combined with an ongoing decline in remittances.<sup>15</sup> It may be assumed that Kyrgyz labour migrants also possess more formal rights and fewer restrictions on employment in EAEU countries, although there is no evidence to confirm this assertion.

Another advantageous trend is visible in the Kyrgyz–Russian Development Fund, established in November 2014 with USD \$500 million, which aims to boost investment in Kyrgyzstan.<sup>16</sup> The fund increased its level of activity in 2016 by crediting the private sector and promoting import-substitution sectors of the economy, such as agriculture, food processing, construction and textiles. By the end of 2016, the fund had extended loans of USD \$175 million, but the total effect of these loans and investments is yet to be fully evaluated.<sup>17</sup>

Russia has a strong footprint in Kyrgyzstan, but China's role as a development actor and investor in Kyrgyzstan has been growing exponentially in recent years. China became a major donor by funding large infrastructure and energy projects and providing budget support. Prominent projects funded by China include USD \$389 million for the Datka-Kemin energy transmission line, USD \$386 million for reconstruction of a Bishkek energy company and USD \$400 million for construction of the Bishkek-Torugart road, as well as construction of an alternative route linking the north and south of the country.<sup>18</sup>

<sup>12</sup> Sharsheev, I., 'Analysis of the main outcomes of Kyrgyzstan's membership in EAEU', *Central Asian Bureau for Analytical Reporting*, 24 June 2016, <<http://cabar.asia/en/iskender-sharsheev-analysis-of-the-main-outcomes-of-kyrgyzstan-s-membership-in-eaeu/>>.

<sup>13</sup> National Bank of the Kyrgyz Republic, 'Remittances of individuals made through the money transfer system', <<http://nbkr.kg>>, accessed 14 Mar. 2017.

<sup>14</sup> National Bank of the Kyrgyz Republic (note 13).

<sup>15</sup> Mogilevskii, R., 'Labour migration in Kyrgyzstan', Presentation prepared for the workshop 'Connectivity in Central Asia', Vienna Institute for International Economic Studies, Vienna, 15–16 Dec. 2016.

<sup>16</sup> *Times of Central Asia*, 'Kyrgyzstan and Russia set up \$500 million development fund', 25 Nov. 2014, <<http://www.timesca.com/index.php/news/14690-kyrgyzstan-and-russia-set-up-500-million-development-fund>>.

<sup>17</sup> *Kyrgyz Agriculture Bulletin* via ISSUU, '#35 Kyrgyzstan Agriculture Bulletin, BFC', 7 Feb. 2017, <[https://issuu.com/bfc-pub/docs/\\_bfc-kyrgyzstan-agri-bulletin-35-ja](https://issuu.com/bfc-pub/docs/_bfc-kyrgyzstan-agri-bulletin-35-ja)>.

<sup>18</sup> Baktygulov, S., 'China and Kyrgyzstan', *Central Asian Bureau for Analytical Reporting*, 5 Apr. 2015, <[cabar.asia](http://cabar.asia)>. International Monetary Fund, 'Kyrgyz Republic: Medium-term development programme-poverty reduction strategy paper', IMF Country Report no. 12/112, May 2012, <<https://www.imf.org/external/pubs/ft/scr/2012/cr12112.pdf>>.

The extent of such projects is only likely to grow. The Export-Import Bank of China became Kyrgyzstan's largest creditor in 2016.<sup>19</sup> It has outstanding credits of USD \$1.3 billion, which accounts for almost 40 per cent of external public debt. There is also growing interest from public and private Chinese companies in FDI in the energy, airline and construction sectors to access the EAEU market.<sup>20</sup> Given the expansive nature of these, albeit nascent, trends, China is poised to rewrite the rules and alter domestic attitudes to FDI and infrastructure development in Kyrgyzstan.

### **Takeaways**

Overall, it is difficult to assess the benefits of Kyrgyzstan's accession to the EAEU, as its membership has coincided with regional economic and political shocks. The economic prospects for Kyrgyzstan as an EAEU member may be favourable, but it must fulfil the outstanding requirements of EAEU membership. In the meantime, China is clearly increasing its strategic and economic interests in Kyrgyzstan, leading to questions over how the latter will balance its longer-term cooperation with Russia.

<sup>19</sup> Osmonova, N., 'China—largest creditor of Kyrgyzstan—forces KR to abandon sovereign immunity in courts', *24.kg News Agency*, 15 Sep. 2016, <<http://eng.24.kg/vlast/181951-news24.html>>.

<sup>20</sup> Frolovskiy, D., 'Amid Russian downturn, Kyrgyzstan turns to China', *The Diplomat*, 14 July 2016, <<http://thediplomat.com/2016/07/amid-russian-downturn-kyrgyzstan-turns-to-china/>>.