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## The Influence of Financial and Industrial Policy on Harmonization of European and Asian Integration Processes

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### Abstract

*The article is devoted to a research of the influence of financial and industrial policy on harmonization of European and Asian integration processes. Considering geopolitical and macroeconomic risks, real opportunities for the growth recovery of the national economics and sustainable financial policy are limited.*

*They also require integrated development of effective measures of state support for the recovery of national economic growth by supporting the number of main industries. The development of anti-crisis policy should be accelerated in order to create a favorable investment climate in Russia, increase the business activity of economic agents, decrease capital outflow, and reduce the amount of unsecured budgetary commitments.*

**Key Words:** *anti-crisis management, growth recovery of national economics, economic activity, finance and credit policy, inflation, measures of state support, integration processes.*

**JEL Classification Codes:** *E42, E52, F00, G38.*

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## **1. Introduction**

The aim of this study is to determine the characteristics of financial and industrial policies implemented in context of Western sanctions, as well as existing demographic, infrastructural, and institutional limitations, on the development of Russian economy. Continued dependence on global oil and gas prices, low diversification of Russian economy, and other factors limit its potential growth.

Historical experience of Russia and other countries of the Eurasian Economic Union suggest that overcoming these constraints requires significant time and effort. Therefore it is necessary to develop effective anti-crisis financial and industrial policies that would stimulate growth of Russian economy, which is the principal driving force behind the formation and integration of the Eurasian Economic Space.

Economic sanctions imposed by the European Union and the USA have limited the access of Russian companies and commercial banks to capital and new technologies required to implement their investment projects, and thus have creating obstacles to the sustained growth of Russian economy.

The uncertainty of prospects for Russia's economic growth and the harmful effects of prolonged recession require the identification of specific factors limiting the development of integration processes in the globalizing economy. In order to improve Russia's economic situation, the investment scenario of economic development must be implemented, wherein price increases for certain products might lead to a relative reduction in prices in the economy as a whole.

## **2. Theoretical, Informational, Empirical, and Methodological Grounds of the Research**

This study rests on the theoretical framework formed by conceptual approaches to the market economy theory, institutional design, financial economics, modern concepts of the economic growth theory and the "new industrialization", and other factors that determine the direction of contemporary industrial policy, which forms in the context of economic sanctions based on an integrated system of risk management and import substitution programs (Arslan-Ayaydin *et al.*, 2014; Averina *et al.*, 2016; Boldeanu and Tache, 2016; Carstina *et al.*, 2015; Tcvetkov *et al.*, 2015; Theriou, 2015; Budik and Schlossberger, 2015; Thalassinos *et al.*, 2015).

In order for Russian economy to grow, it needs hard currency and technological resources required for the development and implementation of investment projects. Sanctions imposed on Russia restrict its ability to raise funds in global financial markets in order to implement its energy projects, and thus they increase the risk of prolonged economic recession.

Economic and technological sanctions imposed on Russia by the Western countries have limited the access of Russian companies and commercial banks to the global capital market, and thus their ability to borrow funds and attract investments.

Prolongation and extension of these sanctions by the European Union and the USA would certainly limit Russia's economic growth and decrease its financial stability. Despite certain volatility in the global financial market caused by the United Kingdom's decision to leave the European Union ("Brexit") following the referendum held on June 23, 2016, the current state of the world economy has not deteriorated.

The pace of economic growth in major developed economies has remained stable, and in developing countries, including the Eurasian Economic Union, it has not decreased significantly (Rupeika-Apoga and Nedovis, 2015; Liapis and Thalassinou, 2013; Medvedeva *et al.*, 2015; Allegret *et al.*, 2016; Sharma, 2014; Salimova and Makolov, 2016; Sibirskaia *et al.*, 2016).

Authors of this study evaluate and verify the factors affecting Russia's economic growth, which in 2016 demonstrated better dynamics than in 2014. Naturally, the prospects for economic growth could be positively influenced by increasing oil prices; however the forecasts suggest \$50 per barrel at best. No other major drivers for Russia's economic growth are observed. Should the world oil prices recover, there is an option for budget expenditures to exceed the planned level. Increased economic growth would stimulate consumer activity, but it could also accelerate inflation, which in turn would reduce the investment activity and contribute to reducing the market value of the ruble. If opportunities for implementing the new industrial policy are limited, increased consumer demand would lead to increased imports.

The Center for Strategic Research has proposed a concept of economic development and industrial policy in which investments should be private, and the state should create favorable conditions for investment activity: ensure macroeconomic stability and low inflation, reduce budget deficits.

Another concept of economic development was proposed by the Stolypin club. In its medium-term development program called "The Economy of Growth" the club announced a project of a new "financial-industrial policy". The interdepartmental group for the development of the concept of "The Economy of Growth" program was created in April 2016 by order of Prime Minister Dmitry Medvedev.

This concept stipulates the need for methodological development and implementation of a new model of economic growth. A comprehensive set of measures to stimulate economic growth must be carried out by the Central Bank.

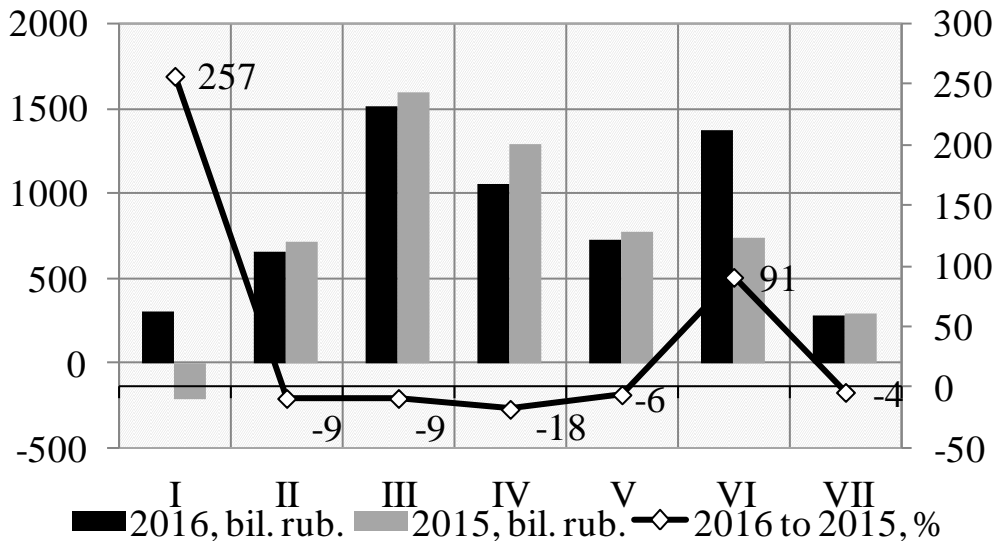
The program suggests that the Central Bank should refinance the loans given to banks and development institutions for the implementation of investment projects. The institutional project of Eurasian integration was based on the concept of creating an economic unit (a common market). Categorical meaning of this integration lies in the system of establishing relations with other centers of the world economy (the European Union, countries of Southeast Asia, China and others). It is quite obvious that the Eurasian integration project was created on the basis of the best practices adoption from positive experience of the European Union formation and development.

This principle as well as other long-term purposes of the union development was borrowed from the EU. The EAEC focuses on the European Union experience in the development of its institutional base too, which provides three stages: gradual removal of trade barriers, creation of common industry markets and transfer of control functions to the supranational level. 2025 year is the time of commencement of the EurAsEC (EAEC) functioning in full (completion of common markets creating, adaptation of national legislation, launch of all supranational bodies, etc).

### **3. Results**

Currently, the pace of economic growth is determined by low economic activity, limited consumer purchasing power, reduced foreign financing and investment inflow. Inflation has slowed down in 2015-2016, although certain inflation risks remain. The Bank of Russia's moderately tight financial policy has provided the prerequisites for financial stability.

According to the Ministry of Finance of the Russian Federation, in the first half of 2016 the federal budget revenues amounted to 5.9 trillion rubles, which is 11% lower than the same period in 2015. Low revenues have a significant impact on the expenditure policy. Federal budget expenditures amounted to 19.3% of GDP.



**Picture 1.** Net financial result of Russian companies (Official statistics by Federal State Statistics Service of Russia – Rosstat, 2016)

In nominal terms, federal budget expenditures have decreased slightly (by 0.5%) as compared to the first half of 2015. However, according to A.D. Khaitun, professor of the Institute of Europe of the Russian Academy of Sciences, in real terms there is a decrease of 8%. As a result, in terms of constant prices, expenditures in the first half of 2016 roughly matched the level of 2011. In 2015, reduction in real expenditures occurred in the regional budgets as well (Khaitun, 2016).

Russian oil and gas revenues decreased by 29% – down to 2.1 trillion rubles, which is an all-time low since 2010 -- and amounted to 15.3% of GDP. This is evidently the main cause of low federal budget revenues. The average price for Urals oil in January-June 2016 was only \$37 per barrel, while in 2015 it was \$57.1 per barrel. For comparison, in the first half of the crisis year of 2009 the price of oil was \$50.5 per barrel, while a price level similar to the current one was last seen in 2004. In nominal terms, oil and gas revenues exceed the level of both 2009 and 2010, but only because this year's fall in oil prices have been partially offset by the depreciation of the ruble. Due to low oil prices, oil and gas revenues amounted to only 36% of total budget revenues.

Rosstat's data on GDP shows that economic decline in the 2nd quarter of 2016 has doubled in comparison to the 1st quarter, and amounted to -4.6%. Two consecutive quarters of economic decline signify that Russia's economy is in recession. The fall of oil prices and the weakening of the ruble increase the risk of deepening the recession, while the process of economic recovery cannot initiate due to a lack of necessary growth factors.

In order for Russian economy to grow, it needs hard currency and technological resources required for the development and implementation of investment projects. Sanctions imposed on Russia restrict its ability to raise funds in global financial markets in order to implement its energy projects, and thus they increase the risk of prolonged economic recession.

According to Moody's experts, the sanctions have virtually cut off access to international capital for Russian commercial banks and companies working in the extractive industry, as well as in the military-industrial complex. According to IMF estimates, the sanctions, along with Russia's counter measures in the form of restrictions on food imports, reduced real GDP growth by 1-1.5% in 2014. The IMF calculations take into account that Russia will not have the international technologies and capital needed for the exploration and development of new hydrocarbon deposits, Moody's analysts indicate (Kuvshinova, 2016).

By the end of 2016 total payments on foreign debts should reach \$61 billion, although according to the Bank of Russia's estimates the real amount of debt to be repaid is smaller. However, the situation dictates that Russian economic agents have to use the hard currency that is available to commercial banks and corporations mainly to repay foreign debts. Based on the forecast of oil prices, the Bank of Russia has developed several scenarios for Russian economy over the next three years: base, risky, and optimistic. In the base scenario, the price of oil is \$40 per barrel, in the risky scenario it is \$25 per barrel, while the optimistic scenario assumes that the oil price will rise from \$40 to \$55 per barrel by 2019.

While it does not rule out the possibility of a rise in oil prices in 2016, the Bank of Russia predicts not growth but a decrease in Russia's export capacity, because the dynamics of non-oil exports did not meet expectations. As a result, the Bank of Russia's new prediction on the contribution of net exports to GDP is 1.5 lower than before. Net exports will be supported by reduced imports due to limited effective demand.

Although analysts predict an investment slowdown in Russian economy, net capital outflow (which in the first eight months of 2016 amounted to \$9.9 billion) was replaced in August 2016 by a net inflow of \$1 billion. Russia's financial policy remains uncertain in regard to the budget for the next three years. At the same time, in order to ensure the stability of the national economy, the Bank of Russia intends to carry out certain structural reforms aimed at reducing inflation and keeping it at a low level, to ensure price stability and give credibility to the macroeconomic policy.

Due to the impact of these negative factors, Russia's economic growth will be falling behind the world average until 2020. According to Mr. Andrei Klepach, deputy head of the Vneshekonombank (VEB) public company and a participant of the round table "Economic Growth in Russia" it is possible that "up to 2020, and even up to the beginning of the next decade, we will not be able to catch up with the

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pace of global economic growth, and only later will be able to reverse this trend” (INTERFAX, September, 20, 2016).

Mr. Klepach says that real household incomes will reach the pre-crisis levels by 2020 as well; according to Rosstat, real incomes decreased by 0.7% in 2014, by 4.7% in 2015, and by 5.8% in the first eight months of 2016; in August 2016 the decrease reached 8.3% - the highest level since December 2008 (INTERFAX, September, 20, 2016).

According to Mr. Klepach, Russian economy will remain dependent on the export of energy resources up to 2030-2035. He says that it has the potential to significantly accelerate its growth without overheating by using the National Wealth Fund and other available resources. While the economy is in recession, Russian industrial companies assess their supplies as adequate and do not increase them, because they do not plan to increase production. Russian industry shows no signs of growth either, as the investment activity of enterprises has been decreasing since 2014 due to reduced demand for their products.

According to a study performed by reputable scientists and presented at a press conference at Interfax, the most negative scenario for Russian economy is if businesses decide to cut expenses by making products of lower quality, employing unskilled workers, and decreasing high-tech production. Scientists have noted that the current exchange rate of the ruble affects the goods of higher quality manufactured from imported materials and components.

According to researchers, there is a certain risk that striving for lower prices might lead to simplification of consumed products, and thus there is a real threat of degradation of production (INTERFAX, June, 22, 2016). According to A.D. Khaitun, professor of the Institute of Europe of the Russian Academy of Sciences, another danger would be a new policy of strengthening the ruble, which could be adopted as soon as the middle of 2016 in order to attract investments and foreign production capacities to Russian economy. This could lead to a decline in demand for products of Russian industry due to reduced effective demand within the country and decreased export efficiency.

Among Russian economists there are two opposing views on the economic policies needed to address budget problems and stimulate economic growth. One of them is the concept of scenario approaches, developed by the Center for Strategic Research (presided by Alexey Kudrin, vice-chairman of the Economic Council Presidium) and “Stolypin club” (a scientific organization lead by Boris Titov).

According to Mr. Kudrin, the greatest risks for Russian economy are posed by the collapse of the ruble (caused by the drop in oil prices) and the shrinkage of trade. On July 13, 2016, during a meeting of the Economic Council Presidium on strategic

development and priority projects, Mr. Kudrin acknowledged that Russian financial and credit markets declined as a result of the decreased oil revenues (Kudrin, 2016). Having limited stabilization funds to cover the budget deficit, Russian government has to attract capital by issuing government bonds. There are fewer resources required to implement the concept of economic growth and achieve planned performance. Therefore, it is important to redirect these resources to the priority areas of Russian economic development. In recent years, defence and welfare have been the most dynamically developing areas of state expenditure. Both of them have grown by about 1.5% of GDP.

In order to keep priority spending at the same level, resources must be reallocated from other areas. In order to solve this problem, new crisis management tools are required. Combined labor and capital productivity has been decreasing since 2005. This situation indicates a structural imbalance in the Russia's model of economic development.

Russian Minister of Finance Anton Siluanov stated in his report "Focus areas of Russia's tax policy for 2016-2018", presented in 2015 at parliamentary hearings in the State Duma, that Russian government does not plan to carry out any major tax reforms until 2019, and it intends to adhere to the moratorium on increasing the tax burden (Siluanov, 2016). The reasoning behind this decision is that major tax reforms have already been carried out in Russia recently, with the implementation of a "tax maneuver" in the oil industry, the introduction of the concept of deoffshorization, and reforms in property taxation. Enforcing the new tax policy is going to be the main task of the Ministry of Finance and the Federal Tax Service in the near future. New tax policy is expected to encourage economic growth and promote structural changes in Russian economy, as well as increase the validity of Russian tax system by providing benefits to diligent taxpayers.

Innovative solutions need to be implemented in the Russian tax policy in the near future. Thereby a new taxation structure for the oil industry is being institutionally developed. Currently, the Ministry of Finance collects oil rent as oil duty and as Mineral Extraction Tax. Since 2016 a tax maneuver has been implemented: the Mineral Extraction Tax has been increased, while the oil duty has been reduced. In 2017 the oil duty will be about 30%.

Tax modernization aims at getting rid of oil duties by 2018. The Mineral Extraction Tax will be increased accordingly. This tax can also be replaced with a new profit-based tax, which is being discussed in the course of developing a new institutional model of taxation. Abolishing oil duties would consequently lead to abolishing all duty exemptions. As a result, these changes will lead to widening the tax base: currently only exported oil is subject to duties, but the profit-based tax will apply to all oil extracted in the country.



The tax maneuver consists in increasing the Mineral Extraction Tax (from 857 rubles/ton in 2016 to 919 rubles/ton in 2017) while reducing the export duty down to 30% from the current 42%. The Ministry of Finance proposes to reduce the export duty down to zero in 2018, while further increasing the Mineral Extraction Tax. It was originally planned to abolish the export duty after 2025, however the imbalance in the financial sector caused a discussion on accelerating tax reforms. These reforms are predicted to provide an additional 200 billion rubles of budget revenues per year in 2017-2018, and 317 billion rubles in 2019. If the oil price rises, budget revenues could become even greater. But the exact impact on the budget will depend on how this additional income is managed.

In 2016 the oil-producing corporations have to pay more taxes, because the Russian government has decided against the planned reduction of duties, while the Mineral Extraction Tax has been increased as planned. The Ministry of Finance planned to collect an additional 200 billion rubles, but if the oil price gets down to \$30 per barrel, the budget might only collect 65 billion. In order to maintain the stable operation of oil-producing companies, the mining tax burden should not grow. The Mineral Extraction Tax should increase concurrently with the decrease of export duty. But abolishing the export duties on oil and oil products would also lead to abolishing the export subsidy provided to oil refineries. Export subsidy is the difference between the duties on crude oil and on oil products. The existing mechanism allows inefficient refineries to export oil products with low refining ratio. Abolishing this subsidy will collect an additional 600 billion rubles for the state budget.

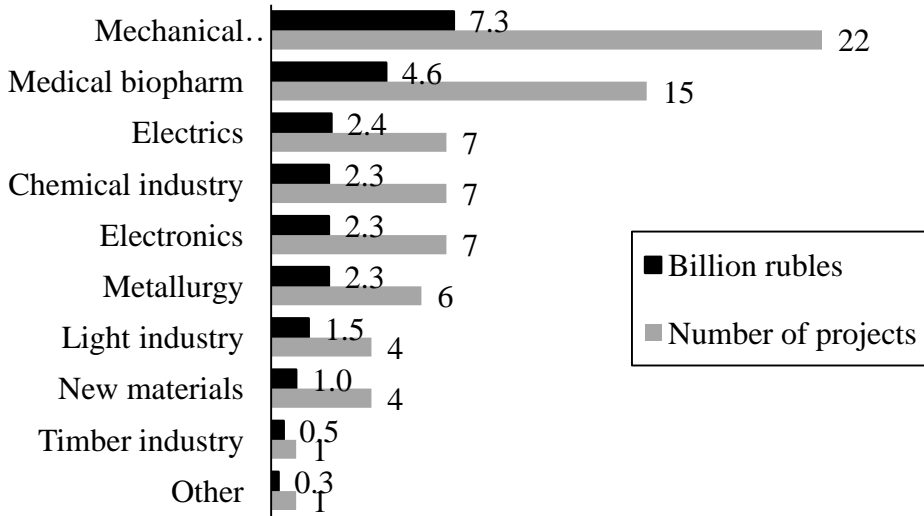
At the same time, abolishing the export duties would automatically lead to an increase in domestic oil prices, which in turn would lead to a drastic decrease in refinery margins. In order not to harm the entire oil refining industry, the regulating authorities plan to support it through negative excise duties on oil.

When buying oil, the refineries will have to pay an excise duty to the budget, and then receive a deduction for the amount of the excise duty multiplied by a scale-up factor. Experts estimate this compensation to be equal to the export duty that is being abolished. For example, with the oil price of \$50 per barrel the compensation would be about \$4.5 per barrel, and with the oil price of \$40 per barrel it would be about \$3 per barrel. Supporting efficient refineries through negative excise duties can collect approximately 300 billion rubles (Bazanova, Papchenkova and Sterkin, 2016).

It is expected that the Russian budget can collect an additional 130-150 billion rubles by abolishing customs subsidies for Belarusian oil refineries. Oil is exported to countries of the Eurasian Economic Union at domestic price, which will automatically increase with the abolition of export duties. If negative excises end up not being enough compensation for the refineries, oil companies could raise prices for gasoline; an increase of 2 rubles per liter would provide them with additional 100-200 billion rubles of revenues. The government could keep the price of gasoline

at the same level by reducing excise duties, if this served its interests. Abolishing the export duties with the oil price of \$50 per barrel would increase the domestic price by about 5500 rubles per ton. This would be only partly offset by abolishing export duties on oil products.

It should be noted that conceptual changes in the mechanisms of implementation of financial and tax policies should help to reduce the energy intensity of the Russian economy. Institutional design, development and implementation of such policies would ensure the emergence of additional oil resources needed to expand the export component of Russian economy. The system of export duties is considered to be less effective for maintaining economic growth than direct targeted subsidies. However, the rise of domestic prices of oil products will likely have a negative impact on economic growth, and can lead to a decrease in the competitiveness of certain sectors of the economy.



*Picture 2. Industry Development Fund projects, 2015 (Nikolaeva, 2016)*

New direction of financial policy could act as a basis for the development of an institutional mechanism of economic growth in the context of limited financial resources and tougher sanctions. In September 2016 the Lower House of the US Congress adopted a law on support of Ukraine, which provides for tougher sanctions against Russia as well as increased control of compliance with the sanctions regime. The new law also provides for gathering information on banks that illegally control Ukrainian assets, in particular the Russian banks in Crimea. This law includes a paragraph on remaining in effect for five years from the day it enters into force (Kuznetsov, 2016).

At present it seems appropriate to abandon the discussion on the conservative scenario with an average annual oil price of \$25. The base scenario can be considered as conservative now, as budgeting for the next 3 years was based on a higher oil price (\$40). The more optimistic scenarios are the “base plus” scenario and the target scenario (with the average price of oil being \$50-55). The base scenario does not provide for changes in the economic model. The budget for 2016-2019 is deficit in all three scenarios, so in order to replenish it the government will have to spend reserves, take loans inside and outside the country, and privatize state-owned companies.

Authors from the Center for Strategic Research do not believe that economic growth is hampered by a lack of funds, as the bank accounts of Russian companies hold more than 14 trillion rubles, which is comparable to an annual need for investments. However, authors of “The Economy of Growth” program point out that these funds are in possession of mining corporations that are not going to invest them; this money is stored in accounts of commercial bank that provide loans at very high interest rates.

The demand for cheap financial resources is enormous, and so new tools for attracting them must be found. As an example, having limited financial resources in the long term forced Russia to issue additional eurobonds. On May 23, 2016, Russia has placed 10-year eurobonds worth \$1.75 billion at 4.75% interest per annum, the sole agent of placement being VTB Capital commercial bank. Russia is going to place an additional issue of eurobonds maturing in 2026 worth up to \$1.25 billion. Reference placing price is 106% of the nominal value, which corresponds to a profit of 3.99% per annum (INTERFAX, September, 22, 2016).

The Ministry of Finance needs to finance the budget deficit in the context of low oil prices and an uncertainty regarding major privatization deals. The law on budget will allow it to attract \$1.25 billion from abroad this year. In late September 2016 there seems to be a favourable situation for placing new bonds: such profit rates for trading eurobonds were last seen in 2010. Bonds were placed by a Russian investment bank, VTB Capital. Clearing is carried out by the National Settlement Depository and the Euroclear bank. Applications for the 10-year eurobonds have already exceeded \$3 billion (RBC Newspaper, September, 22, 2016).

The last time that Russia borrowed from international markets was in 2013, when the Ministry of Finance placed securities for \$6 billion maturing in 2019, 2023 and 2043. At present the Russian Eurobond market has a significant deficit of securities. Considering the constraints placed on major Russian issuers by the sanctions, this deficit will increase. About 35 issuers of eurobonds are under sanctions. A significant part of the market participants issue short-term bonds only. According to the prospectus, Russia shall not use the funds received from the placement of securities for the benefit of individuals or entities that are under EU and US sanctions.

In turn, the Bank of Russia has approved the parameters for issuing its own securities, the Bank of Russia bonds (BRB). Decisions on specific issues of BRB will be made by the Board of Directors of the Bank of Russia as appropriate, in view of the transition to structural liquidity surplus in the banking sector, and its subsequent dynamics. BRB will be issued with maturities of 3, 6 and 12 months. The coupon period is set equal to the minimum circulation term of BRB, which is 3 months. The coupon rate for BRB will be equal to the key rate of the Bank of Russia for each day of the coupon period. This is aimed to maintain money market rates close to the key rate in the context of structural liquidity surplus.

The Bank of Russia stopped issuing its bonds almost 5 years ago due to a lack of demand during the time of liquidity shortage. However, the ruble liquidity flow caused by the Ministry of Finance spending the Reserve Fund money in order to cover the budget deficit, as well as the emerging liquidity surplus in the banking sector made the regulating authority to revisit the idea of issuing bonds. New securities for 1 trillion rubles can be used in case of a significant liquidity surplus. The Bank of Russia expects to reach sustained liquidity surplus in 2017. Currently liquidity surplus and deficit are both tested as possible scenarios. In order to collect excess liquidity from Russian commercial banks, the Bank of Russia regularly holds deposit auctions. In September 2016 the Bank of Russia held 3 auctions for a total of 666 billion rubles.

In addition, in April 2016 the Bank of Russia began to sell its federal loan bonds (OFZ). In April - August 2016 the Bank of Russia sold OFZ bonds from its own portfolio for a total of 132.5 billion rubles. Russian commercial bank Otkritie has been holding a series of meetings with investors from Europe and Asia since September 2016 over the placement of eurobonds, said Bloomberg citing two sources (Pronina L., 2016). Societe Generale CIB and Citibank have been appointed as the global coordinators of the forthcoming deal. Joint leads are managers and bookrunners (Citibank, Commerzbank, ING, Raiffeisen Bank International, UniCredit, VTB Capital).

The executives of the Russian bank consider this placement of bonds as an opportunity to diversify its funding sources and reduce the cost of borrowed funds. In August 2016, Khanty-Mansiysk Bank Otkritie was merged with Bank FC Otkritie. In 2018 Bank Otkritie will have to repay \$500 million for eurobonds. Therefore, the forthcoming placement of bonds is planned for the same amount, about \$500 million. Bank FC Otkritie is one of the top ten largest Russian banks, ranking 5th in terms of assets (2.75 trillion rubles), while the Khanty-Mansiysk Bank Otkritie ranked 18th place in terms of assets (462 billion rubles).

Currently the average yield on five-year bank bonds is around 4%. We can assume that demand will be relatively high due to a limited supply on the part of Russian banks. Because of the sanctions, large Russian banks with state participation do not go to the world market with new bond placements, while private banks aren't active

because they do not require hard currency liquidity. In 2015-2016 Russian issuers were mostly redeeming their own eurobonds which were traded below par.

Several Russian commercial banks have been active in placing eurobonds: Binbank issued securities for \$150 million for 3 years; Renaissance Capital issued securities for \$200 million for 5 years, and plans to place eurobonds for \$300 million; Alfa-Bank placed eurobonds for \$500 million with a yield of 5% in November 2016. Currently this placement is traded above par, and securities can be purchased at a yield of 2.9-3.11%.

According to the website of the Irish Stock Exchange, a subsidiary of Russian Railways, RZD Capital P.L.C., announced an offer to repurchase eurobonds totaling \$1.5 billion maturing in 2017, and 525 million francs maturing in 2018. Offers are accepted in accordance with conditions of the tender offer of September 19, 2016.

JSC Russian Railways (RZD) is ready to participate in the reconstruction and management of railways in Greece. RZD's interest in Greece is part of its strategy of involvement in Pan-European transport corridors, along with the reconstruction of the tenth Pan-European corridor in Serbia (PRIME Business News Agency, 2016). Thus, at present, different models of economic growth are being developed based on the methodology of institutional design.

In order to develop an effective model of economic growth, Russia needs to surround itself with like-minded allies and reliable partners. To achieve this goal, it adopted a strategy of regional integration, which is being implemented in the framework of the Eurasian Economic Union, created in January 2015 on the basis of the Customs Union of Belarus, Kazakhstan and Russia.

The treaty on formation of the Eurasian Economic Union (EAEU) was signed in Astana on May 29, 2014. The treaty states that the long-term goal of the integration of its member countries is to create a full-fledged economic union based on the four freedoms: free circulation of goods, services, capital, and labor. The EAEU has been operating since 2015; it consists of five post-Soviet states - Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Russia. According to scientists, the priority of the political aspect of the EAEU over the economic aspect is illustrated by the fact that trade with the Union countries forms a considerably small part of Russia's foreign trade - in 2015 it amounted to only 7.8% of its total volume (Panasik, 2016).

The aim of the institutional project is to stop the disintegration processes occurring in the economic space surrounding Russia. Russia's previous attempts to implement its European and Eurasian projects were unsuccessful: CMEA and USSR collapsed, while economic cooperation within the Commonwealth of Independent States (CIS) has been limited. This can be explained by the fact that the countries of the Commonwealth differ in their economic development and political priorities. Some CIS countries that were focused only on Europe joined the European Union. The

CIS countries are similar in their economy. They travelled the same road, from socialism to capitalism, by ways of privatization and de-privatization, etc.

In September 2016, Bishkek will host the jubilee summit of the heads of CIS states. Russian president Vladimir Putin and his colleagues will sum up the results of 25 years of existence of the Commonwealth, and discuss ways to adapt to the changing political and economic environment. In the years of its existence, CIS has become an important platform for the integration of its participating states. The creation of CIS led to the development of political and trade-economic cooperation between the countries.

CIS countries signed an agreement on the creation of a free trade zone, which allowed them to trade with each other on more profitable terms, as well as to integrate into the international trading system. Modern achievements of CIS are, among others: preservation of free trade, visa-free travel, and common legal space, combating international terrorism, and resolving or freezing conflicts.

Free trade within the CIS and open access to the Russian market has been of particular importance to the economies of most member countries. Cooperation in the area of migration based on the visa-free regime also plays a significant role in the development of countries. Tens of millions of people are able to freely visit their relatives and friends, and work in other CIS countries, especially in Russia.

However, the impact of the CIS could have been much more significant. It was limited by a lack of political unity and focus on Eurasian integration. It is important to note that the Alma-Ata Declaration defines one of the goals of the CIS as participation in the unified Eurasian and European markets. At the same time Russia, Belarus, Kazakhstan and some other CIS countries never contrasted Eurasian and European integration, considering the Eurasian unity essential for European cooperation.

Today a number of active CIS members (Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan) participate in deep Eurasian integration institutions: the Union State of Russia and Belarus, the Eurasian Economic Union (five states).

#### **4. Conclusions and recommendations**

Experience accumulated for over twenty-five years allows making some conclusions about the Eurasian cooperation as a whole (Naryshkin, 2016):

1. The CIS countries integration different in levels and speed should be based first of all on their economic development. The EurAsEC practice (from 2000 to 2014) has shown the impossibility of Eurasian integration only on the basis of participating in these unions countries political willingness. Therefore in the EurAsEC “system of reference” three most advanced at that time CIS countries: Belarus, Kazakhstan and

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Russia created in 2010 a fundamentally new integration association, the Customs Union, which allowed establishing the Eurasian Economic Union in 2015.

2. The Eurasian project is open to other CIS countries. However new members should be admitted subject to their economic and political readiness for integration. Therefore Armenia and Kyrgyzstan became members of the Eurasian Economic Union having fulfilled a set of necessary economic and legal conditions fixed in the "road maps".

3. Functional and institutional development of the Eurasian integration is closely connected to each other. Thus the rate of formation of a common market of goods, services, capitals and man power is largely determined by the efficiency of the Eurasian Economic Commission and the Eurasian Court activity, as well as cooperation of the parliaments on unification and harmonization of national legislations.

In 2016 there was expansion of competencies and clarification of powers of the Eurasian Economic Commission (EEC), a supranational body of the Eurasian Economic Union (EEU) of the EurAsEC. New members of ECE board started performing their duties; the structure of board has changed, new departments were created. Change of structure is also conditioned by joining of Armenia and Kyrgyzstan to the EurAsEC (EAEC). Discussion on the EAEC expansion continues. A free trade zone between the EurAsEC (EAEC) and Vietnam is being created; negotiations with Iran, Egypt and other countries are underway. During implementation of the Eurasian integration institutional project customs and tariff, technical, sanitary, phytosanitary and other control is fixed at the supranational level. In future the control of financial market, information sector etc. will be transferred to the supranational level. The project of Eurasian integration creates both opportunities and risks for member countries national business operating in the EurAsEC (EAEC) space.

In the process of institutional design of integration projects a real blocking of initiatives announced by national controllers, but requiring approval of other regulators of the EurAsEC (EAEC) countries and confirmation of the supranational bodies. For example permission of parallel import within EAEC promotes a number of Russian stakeholders (Federal Antimonopoly Service and others). A long process of coordination of rules and laws between the member countries of the integration project creates certain risks for national and joint business development. Especially if we are talking about changes in the existing regulation, which on certain factors has a negative impact on business. In this case the process of supranational acts revision may also slow down.

Since 2016 the powers of EurAsEC (EAEC) supranational bodies in the regulation of a number of industries when creating integration space have been greatly expanded. This relates to circulation of medicines and medical devices, where since the 1<sup>st</sup> of January 2016 the first two common EurAsEC (EAEC) markets have been

launched: such powers as development of general requirements to all stages of medicines and medical devices circulation, to their safety and quality have been transferred to the supranational level.

The following areas have been transferred to Eurasian Economic Commission (EEC) competency: foreign trade, customs tariff regulation, nontariff regulation (including introduction of special protective, antidumping and countervailing measures) as well as technical regulation. The spheres of information and communication technologies and informatization were included in the ECE competency. In addition, in 2016 two new departments were created: of internal market functioning and labor migration. In other economy sectors in which the launch of the integration projects and common markets is planned later (financial services, transport, energy, public procurement) the process of transferring powers to the supranational level will last until 2025.

The EurAsEC (EAEC) initiated negotiations about economic partnership with ASEAN and SCO but the structure of partnership remains unclear. For example SCO has not dealt with economic issues before. At the same time this partnership may include mutual investment protection mechanisms and granting access to services and capital markets. A cease of negotiations on integration basis for economic cooperation with the European Union and creation of a free trade area with the European Union is a negative result of mutual sanctions, the so-called "sanction wars" between Russia and the European Union. As a result of application of the sanction wars policy Russia and many European countries got into the "institutional trap". Various models of EurAsEC (EAEC) and the EU cooperation were actively discussed in the process of integration cooperation design in 2013. Eurasian integration project served as a convenient format for economic cooperation with the European Union, as well as the basis for the institutional design of a flexible trade cooperation system, e.g. creation of a free trade zone of the EAEC and the EU. In 2014 negotiations between the EAEC and the EU stopped as a result of mutual economic and trade sanctions introduction between Russia and the EU.

Angela Merkel, German Federal Chancellor, points out the need to develop of the Eurasian Economic Union in such a direction as to have good relationship with the EU. German Federal Chancellor announced interest in proximity of the Eurasian Economic Union and the European Union (Vedomosti Newspaper, July, 14, 2016). To stimulate the integration process it is important to use the existing European experience, to form actively intergovernmental working bodies, which would be able to coordinate positions of countries in the dialogue with Eurasian Commission, maintain an effective balance between supranational executive bodies and intergovernmental institutions, thus coordination of national interests on 75-80% of the issues will be possible. The issues of sectoral integration which served as a basis for the integration processes during the European Union creation (Coal and Steel Community) should be highlighted as problem areas that arose during institutional



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project implementation.

Four main factors contributing to integration were chosen in the process of the Eurasian Economic Space formation. These factors were based on ensuring freedom of goods, capital, and people and services movement. The limiting factor in the Eurasian Economic Space development was the fact that the issues of formation of an effective industrial policy ensuring technological sovereignty of member countries and their competitive strength did not become a priority.

At the same time, to ensure profitability and financial stability industrial companies of the member countries must have a high innovative component of development. Integration trends and market opening does not automatically provide the Customs Union industrial enterprises with competitive stability in the rivalry with the European Union, China or the United States companies. Creation of a single economic organism is possible only through development of sectoral cooperation, effective instruments of industrial policy control and financial and credit solutions, providing methods of state financial support. The collective work of political scientists, historians, economists, philosophers, sociologists of the Eurasian system institutional project should be underway as a part of network scientific programs. Scientific meetings, conferences, joint programs and inventions will ensure formation of a new vector for sustainable development in all the member countries of the integration project, elaboration of a coordinated strategy for development of industrial policy and anti-crisis management instruments of national companies development support.

For example the Russian Federation Government Decree signed recently by Prime Minister Dmitry Medvedev (comes into force from 1<sup>st</sup> of January 2017) ensures priority of suppliers of goods, works and services from Russia in state-owned companies and natural monopolies order. This priority is also applied to suppliers from the Eurasian Economic Union countries; it emphasizes that customers should take into account the provisions of the EAEC agreement. An application with Russian goods and services will automatically receive a 15% price advantage (Vedomosti Newspaper, September, 16, 2016). New rules will give the Russian manufacturers more opportunities to promote their products but competition will remain: if the quality of Russian goods or services will be low the supporting instruments and price preferences will not help these manufacturers. It is known that in the prior period limits for foreign goods were set only for state procurement. A similar price advantage exists among Russian suppliers in state order but only for a limited list of goods (15% for food, utensils and equipment).

There are various restrictions on state purchases of 420 kinds of foreign goods. A part of the imported goods cannot be bought in case there is a Russian analogue (defense products, programs), for other the prohibition is in force in case there are two Russian analogues; it is applied to public purchase of medicines and medical devices. The prices of public contracts have grown approximately by 40% as a result

of import substitution. It is important to note that emerging price priority will ensure support for innovative Russian companies. The Eurasian Economic Commission together with the EAEC member countries Governments are actively working on the preparation of the draft EAEC Customs Code agreement. 30 disagreements of the countries arisen in the development of the draft agreement had been considered, 19 of which had been resolved and 11 remained unresolved, as reported in the SCC statement after the meeting of deputy heads of the EurAsEC countries relevant ministries (INTERFAX, July, 12, 2016).

The disagreements subject to discussion relate in particular to determination of the exported goods origin; peculiarities of extra payments of import duties on goods manufactured nominally in one of the member countries with the application of the import customs duty rates lower than the EurAsEC Common Customs Tariff provides; peculiarities of application of the customs procedure of free customs zone in its territories, borders of which wholly or partly coincide with areas of the EurAsEC customs border.

Dmitry Medvedev urged his colleagues from the Eurasian Economic Union to aim in the preparation of the documents of the Union to ensure them to have a minimum of limitations and exceptions. For further growth of goods turnover (within the EAEC) it is extremely important to eliminate the remaining omissions and seek to ensure that the documents in the Union that are in preparation, originally had a minimum of restrictions. It is important not to slow down the pace of legal work improvement and for this it is “necessary to maintain essentially and ideally eliminate the backlog in the preparation of the Union legal acts” (INTERFAX, August, 16, 2016). The instruments of anti-crisis policy will contribute to increase in supply of quality goods and services in the domestic market. For state support measures instruments of financial and credit policy ensuring stability of the companies are necessary. Mutual trade of the Eurasian Economic Union countries currently amounts to only 13.5% of their total foreign trade, therefore restructuring of economies of the Eurasian Economic Union member countries is required. In the goods structure of the EAEC countries export the raw minerals prevail; this is about 70% of total export; and machinery and equipment amount to 45% in total import (INTERFAX, June, 21, 2016). This is a classic scheme to sell raw materials and buy high conversion products. For financial operators’ stability development it is important to move away from such raw materials orientation and to create joint high-tech industries and diverse production chains of competitive goods. Coordination of industrial policy within the EAEC countries is required in order to avoid creating duplicate productions. Participants of the ASEAN Summit held in May 2016 spoke in favor of the idea to unite the integration unions’ efforts, the EAEC, SCO and APEC economic integration in those areas where it is possible in order to eliminate any duplication and parallel operation.”It is important to create favorable conditions for business development”, said the President of the Russian Federation Vladimir Putin at the press conference after the “ASEAN – Russia” summit (INTERFAX, May, 20, 2016).

In his opinion this is a complex process which is associated with objective negotiations not only on countries, but mainly on commodity groups. Russia and other partners believe that they are acting in a right way and will explore the possibility of movement along this path “without any jerks”. Referring to China's position on this issue V.V. Putin, answering the “Interfax” question, said that the idea of the “Silk Road” Economic Belt is very close to the integration project. The Russian Federation President declared China's positive position on the uniting efforts within the idea of “Silk Road” Economic Belt and the Eurasian Economic Union, besides he noted that the plans are absolutely identical in this regard.

In conditions of increasing economic sanctions against the Russian Federation it is necessary to develop more actively the Eurasian integration project, which should result in formation in the region of special value and semantic space. As a result of successful institutional modeling of regional economic space the project participants will come close to formation of a new geopolitical reality: the Eurasian space with a special development model (based on the historical and cultural specific of the region), system of international interests and mechanisms of their implementation. For a new attempt to be successful the architects of Eurasian integration should draw conclusions from past failures and to accept them as guidance.

The main purpose of the integration project is to create a stable and investment attractive economic space allowing enhancing benefits of globalization trends and reducing costs. Regional integration is not a purpose itself. Integration project serves as an instrument of ensuring stability in conditions of growing global competition for resources, technique of winning the best positions in the global hierarchy of nations and regions.

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