

## Considering Accession to the Eurasian Economic Union: For Azerbaijan, Disadvantages Outweigh Advantages

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### Abstract

This article weighs the costs and benefits of Azerbaijan joining the Eurasian Economic Union. In analyzing the advantages and disadvantages, the author discusses the economic and social features of accession and concludes that such a move is unlikely given the high political and economic price Azerbaijan would pay. This article was prepared by the Center for Economic and Social Development.

### A New Economic Union

The Eurasian Economic Union (EEU) is an economic integration project, similar to the European Union, proposed by the Russian Federation (RF) in late 2011. The EEU is an extension of existing integrative projects of Belarus, Russia, Kazakhstan and other countries (namely, the Commonwealth of Independent States (CIS), Collective Security Treaty Organization (CSTO), and especially the Customs Union (CU) and Common Economic Space (CES) and would be a kind of supervising commission for the members. The CIS and CSTO cover almost all former USSR countries. The CU and CES, however, were established only between Russia, Kazakhstan, and Belarus in 2010, and the EEU would be a further-integrated model of the CU.

Azerbaijani experts generally regard the EEU as an attempt to re-establish the Soviet Union. This view is supported by the Russian Federation's intentions to establish this integrative project with post-Soviet countries. Because of their negative experience of development as part of the Soviet Union and the economic turmoil faced after gaining independence in the wake of its collapse, Azerbaijanis tend to be wary, if not frightened, of the project.

However, in our view, it is naïve to consider this project as a re-establishment of the Soviet Union. Rather, the project should be considered a tool for Russia to secure its geopolitical interests in neighboring countries. The Russian Federation understands and respects the negative feelings associated with the Soviet Union. Thus in order to influence the post-Soviet countries, Russia considered the Eurasian Economic Union as a more attainable goal, instead of re-establishing the Soviet Union.

According to economic integration classifications, the Eurasian Economic Union is an economic union, rather than a free trade agreement or customs union, and is characterized as a union whose members have:

- established free trade zones among themselves in all economic sectors;
- common external economic and trade policies towards non-member countries;
- common internal policies;

- no customs check points;
- free movement of goods and services;
- unrestricted movement of citizens and capital;
- and, in most cases, a common currency<sup>1</sup>.

### Advantages of Accession

The foremost advantage of Azerbaijan's accession to the EEU would be the likely increase in trade turnover. According to an analysis of the European Bank for Reconstruction and Development (EBRD), Kazakhstan, Belarus and Russia all experienced growth of trade turnover with Customs Union members after creation of the Union. This is a logical consequence of lowering tariffs for CU member countries. It is worth highlighting that the decline in trade turnover in 2009 due to the global financial crisis recovered after two years of accession to the CU. While it is debatable whether this recovery was mainly due to accession to the CU, we should consider that it is impossible to speculate about Kazakhstan's development trends if it had not acceded to the CU. In any case, the CU members experienced an increase in trade turnover, and almost certainly Azerbaijan would also experience similar benefits. For a country having oil exports of more than 90% of its total exports, this could be a good opportunity to diversify the economy.

The increased trade turnover would also increase the income generated by exporting companies, if we believe in the calculations of the EBRD. However, this point is widely debated because of the uncertainty of revenue distribution. It is unknown whether the increased revenue generation experienced by CU countries was due to economies of scale (exporting large quantities at low cost) or due to exports at relatively high prices to non-member countries. However, the latter argument can be debated as well: relatively high prices can hamper sales by making production uncompetitive. Considering these points, the implications of any projected increase

<sup>1</sup> Establishment of a common currency deepens the economic integration and creates monetary union on the basis of economic union. The adoption of a single currency in the EEU, however, is questionable at this point, as there are no official claims. Despite this, the adoption is expected.

in trade turnover for state and private revenues should be regarded with caution. According to EBRD calculations, the revenues of Kazakhstan increased after accession to the CU, which could be the case for Azerbaijan as well.

Increased trade turnover and revenues are not the only advantages provided by the CU to its members. The CU and also Eurasian Economic Union require decreasing trade tariffs. This would lower government intervention in the economy. In a market economy, interventions create more losses than benefits to the economy. According to economic theory, government interventions create a deadweight loss in the economy. In other words, the benefits of trade barriers, taxes and other distortions are exceeded by the total negative consequences of those trade barriers and taxes to the economy. By reducing the deadweight losses, the Eurasian Economic Union would benefit Azerbaijan's economy.

Moreover, if the EEU were to adopt a single currency, it would harmonize the economic development of member countries and decrease the risk associated with currency fluctuations. A single currency in the EEU could be a good harmonization tool to level prices for goods and services among member countries.

Last but not least, accession to the EEU would facilitate free movement of capital and labor. By gaining access to the Eurasian Economic Union, citizens of Azerbaijan would be eligible to live, work, and study at any member country of the Eurasian Economic Union.

In a nutshell, accession to the Eurasian Economic Union would increase wealth by fostering trade and revenue and decreasing deadweight loss. It would also promote harmonization of economic trends across countries and allow free movement of the factors of production. However, there are several disadvantages of accession.

### Disadvantages of Accession

The EEU is expected to harmonize the energy policies of member countries, which would require a uniform internal energy policy among members and external policy towards non-members. This would prevent Azerbaijan from implementing its energy strategy (namely, *vis-à-vis* the EU) independently of other EEU members. Such dependency is unfamiliar to Azerbaijan, which has, to date, controlled its own policy to meet EU demands for energy. Considering that the European Union continues to seek ways to diversify its energy supplies, harmonizing energy strategies and joining at least two other energy suppliers (Russia and Kazakhstan) is not in Azerbaijan's interests. Azerbaijan's inability to dictate its own energy policy would make it hard for the EU to consider it a reliable partner.

The EEU would also adopt a common external economic policy towards non-member countries. Accord-

ingly, if Azerbaijan were to accede to the EEU, it would need to comply with this policy. Because Azerbaijan has several strategic economic partners who are not expected to accede to the EEU in the short or mid-term (for example, Turkey, Italy, the EU, and USA), the uniform external policy dictated by the EEU would hamper Azerbaijan's economic ties with these partners. Building the equivalent economic ties with the Eurasian Economic Union members after accession would be a time-consuming and difficult process.

Moreover, due to the Nagorno Karabakh War a vast number of Azerbaijanis blame Russia for the loss of their lands. In their view, Russia was the reason for economic downturns, political instability, and war in the early and mid-1990s. Such a large part of the population in Azerbaijan experienced these turmoil years and have negative feelings associated with Russia. Now, the Russian Federation announced itself as the successor to the Soviet Union. Integrative projects with the Russian Federation generate fear of a return to the turmoil in Azerbaijan that followed the collapse of the Soviet Union and was accompanied by massive economic losses. From this point of view, the Government of Azerbaijan might face internal pressure if it decided to accede to the EEU. This pressure would be tremendous if it were to accede to the EEU without solving the Nagorno Karabakh conflict.

Another disadvantage for Azerbaijan would be the loss of control over its natural resources. The common internal energy policy of the Union would force the member countries to share benefits from the natural resources with the other member countries. From Azerbaijan's perspective, it would lose control of its reserves, and the Union would be allowed to use one nation's wealth for the benefit of other nations. Historically, Azerbaijan claimed itself as economically profitable during Soviet times. The policy of the Soviet Union to develop unprofitable economies with the resources of profitable ones caused Azerbaijan's economy to suffer and remain under-developed. Due to this, loss of control over its resources and using its wealth to benefit other members of EEU is again associated with negative emotions in Azerbaijan. Moreover, the accumulated total value of petrodollars in Azerbaijan is USD 34.3 billion. After accession to the EEU, the money reserves held by the Central Bank of Azerbaijan to maintain the stability of the Azerbaijani manat would not be required anymore, so it could add those reserves of the Central Bank (USD 11.9 billion) to oil fund reserves to calculate how much money Azerbaijan's accession to the Union would benefit other member countries. The sum is equal to USD 46.2 billion (!). Politically, it would be very hard to spend these reserves on the Union.

In short, accession to the EEU has several disadvan-

tages: loss of control over oil reserves and money, loss of independence in setting economic and energy policy, particularly with respect to the European Union, and damage of reputation in strategic partners.

### Conclusion

Although there may be economic benefits to Azerbaijan's accession to the Eurasian Economic Union, there are substantial political and economic disadvantages associated with it. Moreover, many of the would-be benefits of accession are already enjoyed by Azerbaijan. There already is a visa-free regime<sup>2</sup> between Azerbaijan and post-Soviet countries within the framework of the CIS, so there is no additional benefit to accession in this regard. Tariffs and trade barriers can be lowered by the government even without the EEU, which would eliminate deadweight loss and foster foreign trade.

Thus, there are almost no unique economic benefits of accession to the Union. However, EEU members, especially Russia, have political tools to influence Azerbaijan. Officially, around 600 thousand Azerbaijanis (unofficially, around 2 million) live and work in Russia. If Russia forced them to close their businesses and move to Azerbaijan, this would create substantial challenges for Azerbaijan's economy. Especially since 2013 is a presidential election year in Azerbaijan, Rus-

sia may consider this as a very influential tool. Pre-empting such steps by Russian officials requires either Azerbaijan's accession to the EEU or influential diplomatic moves of Azerbaijani diplomats to indirectly address the threat. Azerbaijan's accession to the EEU would also be in the interest of the existing members. In the event of accession, Azerbaijan should use its tools to secure as many exemptions as possible. For example, to maintain its cooperative links with the EU and Turkey, especially in energy issues, Azerbaijan should get an exemption to opt out of the EEU's common energy policy. These exemptions could be similar to those of the UK when joining the European Union.

Russia should also consider the social situation in Azerbaijan. A huge portion of the population blame Russia for the conflict Azerbaijan is currently involved in. Thus, Russia should either make sure the population trusts it, or help the sides reach a conclusion of the conflict.

Azerbaijan's accession to the Eurasian Economic Union would be very challenging to achieve, due to the aforementioned political, economic, and social factors. However, considering the Union members have or will have some influential tools, Azerbaijan may join the Union. If it does, the UK's experience joining the EU should be considered.

### About the Author

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2 One should note the visa-free regime of EEU allows work and study of citizens, apart from free movement of factors of production. This is contrasted to the visa-free regime of CIS countries which only allows free movement of factors of production.