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THESIS DOCTORAL:

Trade Effects of Regional Economic Integration in Tajikistan: The Case of EurAsEC

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Autoriza a presentación da tese indicada, considerando que reúne os requisitos esixidos no artigo 34 do regulamento de Estudos de Doutoramento, e que como Director da mesma non incurre nas causas de abstención establecidas na lei 30/1992.

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DECLARA:

Ser la autora de la presente tesis titulada "Efectos de Integracion Rexional para o Comercio en Tayikistan: O caso de EurAsEC", dirigida por los Dres. Dña. Dolores Riveiro Garcia, y Don Roberto Bande Ramudo y que es presentada para optar al grado de Doctor por la Universidad de Santiago de Compostela.

Y para que así conste, firmo el presente escrito en Santiago, 4 de mayo de 2016.

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Within the deep thoughts the family in which I throve and the family by which I am surrounded now, I dedicate this work to the meaning of my life

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Resumen

Después de la desintegración de la URSS, tras varios años de guerra civil y con una situación económica muy debilitada, Tajikistán inicia un proceso de integración regional en la segunda mitad de los 90, firmando varios acuerdos de integración económica tanto con países exsoviéticos como con otros países vecinos y con organismos e instituciones internacionales. El acuerdo más relevante de este tipo en el que participa el país, y el que parece tener mejores perspectivas de futuro, es la Comunidad Económica Euroasiática (EurAsEC), formada en el año 2000. El análisis de las opciones de integración seguidas por Tajikistan se realiza en el capítulo dos.

En este contexto, el objetivo último de la tesis es analizar los efectos de este acuerdo de integración para la economía de Tajikistán y, en particular, para el comercio exterior de este país. Antes de abordar el análisis empírico, el capítulo uno revisa la literatura sobre integración económica, centrándose en los potenciales efectos que la teoría de la integración atribuye a un acuerdo preferencial, tanto los efectos estáticos contemplados por las teorías tradicionales como los efectos dinámicos en los que se centra la nueva teoría de la integración económica, en particular para los países en desarrollo.

Tras la fundamentación teórica, se dedican dos capítulos al análisis de los efectos de EurAsEC para Tajikistán. En primer lugar, en el capítulo tres, estimando un modelo gravitacional aumentado, usando datos de panel, para el periodo 1995-2013, se analizan los efectos estáticos de creación y desvío de comercio generados por EurAsEC, tanto para el área como para Tajikistán. El capítulo cuatro estudia los efectos dinámicos generados por EurAsEc en Tajikistan, analizando los efectos para el crecimiento económico, y presenta evidencia sobre varios determinantes del interés por participar en procesos de integración en el caso de países en desarrollo (objetivo de desarrollo económico, factores relacionados con el desempeño del mercado y factores relacionados con el comercio).

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Summary

Since URSS was disintegrated, after several years of civil war and with a seriously weakened economy, Tajikistán begins a process of regional integration in the second part of the 1990's, by signing several economic integration agreements with ex-soviet countries and with other neighborhood countries and with international institutions and organizations . The most significant agreement of this type involving this country, having better prospects for the future, is the Eurasian Economic Community (EurAsEC), formed in 2000. The analysis of the different integration options followed by Tajikistan is undertaken in chapter two.

In this context, the ultimate goal of the research is to analyze the effects of this integration agreement for Tajikistán's economy and, in particular, for the foreign trade in this country.

Before turning to the empirical analysis, chapter one review the economic and empirical literature on economic integration, focusing on the potential effects which the theory of economic integration attributes to a preferential agreement, both the static effects covered by traditional theories and the dynamic effects in which the new economic integration theory is focused, in particular for developing countries.

Once the theoretical part is addressed, two chapters are devoted to the analysis of the effects of EurAsEC for Tajikistán. First, in chapter three, by estimating an augmented gravity model using panel data for the period 1995-2013, we analyze static trade creation and trade diversion effects of EurAsEc on the area as a whole and on Tajikistán. Chapter four study the dynamic effects of EurAsEc in Tajikistan, by analyzing its effects on economic growth, and shows evidence on several integration factors influencing the desirability of developing countries to participate in regional integration agreements (such as economic development objective, market-related and trade-related determinant).

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DE SANTIAGO
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Resumo

Despois da desintegración da URSS, tras varios anos de guerra civil e cunha situación económica moi debilitada, Tajikistán inicia un proceso de integración rexional na segunda metade dos 90, asinando varios acordos de integración económica tanto con países ex-soviéticos como con outros países veciños e con organismos e institucións internacionais. O acordo máis relevante deste tipo no que participa o país, e que parece ter mellores perspectivas de futuro, é a Comunidade Económica Eurasiática (EurAsEC), formada no ano 2000. A análise das opcións de integración seguidas por Tajikistan realízase no capítulo dous.

Neste contexto, o obxectivo último da tese é analizar os efectos deste acordo de integración para a economía de Tajikistán e, en particular, para o comercio exterior deste país.

Antes de abordar a análise empírica, o capítulo un revisa a literatura sobre integración económica, centrándose nos potenciais efectos que a teoría da integración atribúe a un acordo preferencial, tanto os efectos estáticos contemplados polas teorías tradicionais coma os efectos dinámicos nos que se centra a nova teoría da integración económica, en particular para os países en desenvolvemento.

Tras a fundamentación teórica, dedícanse dous capítulos á análise dos efectos de EurAsEC para Tajikistán. En primeiro lugar, no capítulo tres, estimando un modelo gravitacional aumentado, usando datos de panel, para o período 1995-2013, analízanse os efectos de creación e desvío de comercio xerados por EurAsEC, tanto para a área en conxunto como para Tajikistán. O capítulo catro estuda os efectos dinámicos provocados por EurAsEc, analizando os efectos para o crecemento económico, e presenta evidencia sobre varios determinantes do interese por participar en procesos de integración no caso de países en desenvolvemento (obxectivo de desenvolvemento económico, factores relacionados co desempeño dos mercados e factores relacionados co comercio).

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DE SANTIAGO
DE COMPOSTELA

Contents

USC
UNIVERSIDADE
DE SANTIAGO
DE COMPOSTELA

List of Figures

List of Graphs

List of Tables

List of Maps

USC
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DE SANTIAGO
DE COMPOSTELA

Abbreviations

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
APEC	Asia-Pacific Economic Cooperation
CACO	Central Asian Cooperation Organization
CAEC	Central Asian Economic Community
CARICOM	Caribbean Community
CIS	Commonwealth of Independent States
CGE	Computable general equilibrium
CPI	Consumer price index
EAEC	Eurasian Economic Community
EBRD	European Bank for Reconstruction and Development
ECO	Economic Cooperation Organization
ECOWAS	Economic Community of West African States
EU	European Union
EurAsEC	Eurasian Economic Community
FDI	Foreign direct investment
FSU	Former Soviet Union
FTA	Free trade area
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
HBS	Household budget survey
HDI	Human Development Index
IFC	International Finance Corporation
IMF	International Monetary Fund
LSS	Living Standards Surveys
MERCOSUR	Common Market of the South/Mercado Común del Sur
MFN	Most favored nation
NAFTA	North American Free Trade Agreement
NBT	National Bank of Tajikistan
PFM	Public financial management
PIP	Public Investment Program
PPP	Purchasing power parity

PTA	Preferential trade agreement
RTA	Regional trade agreement
SADC	Southern African Development Community
SES	Single Economic Space
SCO	Shanghai Cooperation Organization
TCI	Trade Complementary Index
Taj Stat	Agency of Statistics under the President of Tajikistan
TALCO	Tajik Aluminum Company TJS
UEMOA	West African Economic and Monetary Union/Union économique et monétaire ouest-africaine
UK	United Kingdom
UNDP	United Nations Development Programme
USSR	Union of Soviet Socialist Republics
WTO	World Trade OrganizationGDP

General Introduction

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Introduction

From very broad terms, globalization and regional integration as main features of today's world economy have deep roots since centuries ago, when the idea that cooperation among countries, especially among those who share a common continental territory, spreads. Then, in the last five decades of the XX century, the phenomenon of integration has become more common. Under current world characteristics, such as the increase of globalization -especially in the 90s- accompanied by the predominance of a free-market economic model, which thrives on the exchange between nation-states, integration has become common practice as a measure to improve exchanges between countries and their negotiating position facing other countries. The latter has been achieved through regional integration processes which allow countries to negotiate as a bloc in the global context.

This phenomenon still remains as an important economic and political key strategy, allowing the countries accelerate the unification of their “small” national economies, expand their markets, widen the region’s economic space, and take advantage of the benefits of economies of scale for production and trade, as well as stably maintain their political position, and thereby, maximizing the welfare of their nations. In a deeper context, the integration process increases competition in the global trade and strengthens access to investment, innovation, foreign technology, higher productivity and, eventually, to economic growth.

Looking back at the turn of this century, characterized by turbulent and extreme uncertainty, some mega trends can be observed. One of them is the invasive nature of technology. Another trend is the substantial change in the system of relations between states and societies, from an international to a global configuration setting. At this regard, the analysis of the two concepts related to these changes, integration and globalization, is particularly important. Although we know that the terms integration and globalization are different in contemporary discourse, they are both used either interchangeably or in very close sense, implying that the integration process would lead to the globalization.

Ever since the Second World War, there were several integration initiatives involving countries from the developed regions of the world, but in recent years this process reached nearly all continents (EU, NAFTA, MERCOSUR, ASEAN) including not just developed but also developing countries (UEMOA, ECOWAS, SADC, EurAsEC).

Regionalism, that is the tendency of the states to form regional groups, has attracted considerable attention as a major force for global change. The proliferation and diversity of the regional integration regimes across the world have generated major debates, focusing on the various designs, motives and modalities of participation and varying rates of integration. The 'new regionalism', mainly involving non-Western and often nondemocratic states at various levels of economic development, has greatly enriched the knowledge of regional integration becoming the focus of the so-called 'second wave' of literature on regionalism (Dragneva and Wolczuk, 2013).

One of the most compelling arguments for today's wave of economic integration is its shifting paradigm, as the underlying motives for economic integration in the 1950s and 1960s were very different from those today. Bhalla and Bhalla, (1997) properly have claimed that current initiatives involving developing countries are part of a strategy to liberalize and open their economies to implement export and foreign investment-led policies rather than to promote import substitution.

In a thorough book of Schiff and Winters (2003) about *"Regional Integration and Development"* it was mentioned that in today's new integration wave, or countless integration arrangements, participation of developing countries merit special attention. They have stressed that a new analysis of regional integration agreements with a focus on developing countries have two reasons. First, developing countries are turning to regionalism as a tool for development, and the effectiveness of this tool needs to be assessed. Second, regionalism is part of the global economic environment, and its effects on developing countries need to be better understood. It also seemed desirable to ground the new analysis more firmly in empirical results than had been done previously.

Statement of the Problem. Since the economic integration has attracted considerable attention as a major force for economy growth in developing countries, the relevance of the economic integration has become a controversial topic for academics as well as for politicians of these countries.

Although the question of Tajikistan's integration has been the concern of the country's government since the early years of independence primarily due to the existing political and economic backwardness, the relevance of potential effects from integration on Tajikistan became a more decisive issue currently on the eve of the country's accession to the EurAsEC-Customs Union. In this way, together with other less developed countries,

this process was viewed in Tajikistan first of all as a tool for promoting sustainable economic growth improving the living standards of the Tajik people.

Currently, Tajikistan is increasingly focusing on regional integration. Sustaining this process at a successful stage is vital, not only due to the economic backwardness but also due to policy measures required by a country that together with its neighbors has transboundary nature issues (water and energy, transport and the potential of Islamic Resistance) which inevitably requires integration. So, in Tajikistan regional integration is expected to help in solving development issues along with tariff issues, enhancing the development objectives through the implementation of common projects.

All these important milestones of economic development in less developed countries reveal and require the comprehensive work not only in Tajikistan but in all Central Asian states, in confronting with current regional, transboundary and global challenges. For the purpose of this research, the specific case of the Eurasian Economic Community (hereafter, EurAsEC), signed in 2000, will be taken into account, considering it as the most successful integration process that has taken place since the ending of the disintegration period in the post-Soviet space (Pomfret, 2004; Dragneva and Wolczuk, 2012; Kuzmina, 2012; Libman and Vinokurov, 2010; Cooper, 2013; Kembayev, 2014; Galiakberov and Abdullin, 2014; Yesdauletova, 2014). Since EurAsEc includes developing countries, the analysis of the potential effects of this regional agreement requires an analysis that goes beyond the "old" and "new" regionalism theories.

Research objectives. Our main research interest lies in an evaluation of Tajikistan's integration process, shedding light on the integration path followed by Tajikistan after independence and the expected effects of integration for Tajikistan in the context of the rationality in joining EurAsEC. In achieving this **main objective**, we set several specific objectives.

The **first specific objective** is addressed to reviewing the literature of economic integration, putting special emphasis on the effects for less developed countries, for understanding the strengths and weaknesses of *"traditional and new theories of economic integration"*, basically arguing the reason why the so-called *static effects* are not relevant for integration decisions in developing countries and the *dynamic effects* analysis has to be carried out carefully. In addition, other *integration determinants* in developing countries that go beyond both concepts would be clearly identified.

In an attempt to understand the rationality of the integration decisions of Tajikistan in terms of the potential integration effects on welfare, the **second specific objective** is to improve significantly understanding of the several integration options followed by Tajikistan after independence trying to insert itself into the global economy.

Concerning the **third specific objective**, our interest will turn to the empirical identification of economic integration effects, with the ultimate objective of assessing the static trade effects of the EurAsEC agreement, particularly for Tajikistan. By estimating a ***Gravity Model*** with ***panel data***, we analyze the impact of EurAsEC on member trade flows focusing on ***trade creation*** and ***trade diversion*** effects.

Finally, based on the role of economic integration and the main motivations of the integration groups in the less developed countries, our **last objective** is to carry out assessment on the welfare impact of economic integration and the **main integration determinants** in Tajikistan through **dynamic effects** and the implementation of other **common projects** aimed at poverty alleviation, improving the standard and quality of life by promoting health and education issues, productive employment, services and coordination of foreign policy aiming at peace and security within and between the regions.

Research outline. The present study is divided into **four chapters** providing both theoretical and empirical approaches. The first chapter reviews the literature about economic integration by focusing on three questions, namely, *what* integrations means, *how* integration takes place and, what is the most important one, *why* countries participate in integration agreements.

The word *"Integration"* comes from the Latin term *"integration"*, which means merging, *combining parts into a whole*. In some way, an economic integration emerges from eliminating barriers between countries in a combining process. However, in the economic literature, the term "integration" does not have a clear-cut meaning. At one extreme, the mere existence of trade relations between independent national economies is considered as a form of economic integration; at the other side, it refers to the complete unification of national economies. The economic integration is a "***process***" and "***state of affairs***" (Balassa, 1961).

Bearing in mind that integration is a process, which passes through various stages gradually and progressively, integration takes place by removing barriers between

countries (the ***negative way*** *to integration*); but, as stated by Timberger (1954), integration also requires common institutions and coordinated policies (*the* ***positive way*** to integration). Making progress in the integration process (positively and negatively) the **five integration degrees** in the *Balassa's classification* (Balassa, 1961), are reached.

The **potential effects of integration on welfare**, which explain the interest in join an integration agreement, are analyzed by the **"Traditional economic integration theory"** in terms of *trade creation* and *trade diversion*, the so called **static effects** of integration (Viner, 1950; Meade, 1955; Lipsey, 1957). A "***new regionalism approach***" is undertaken by the "***New Economic Integration Theory***" with a particular accent on the **dynamic effects** of integration including investing, innovation, and technological progress which firstly was led by Balassa, (1961); Hansson, (1962) and Cooper and Massell, (1965a).

As mentioned before, the integration agreements in developing countries show other features which characterize today's *"new regionalism"* for which neither the traditional theory nor the new theory are fully applicable (Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al, 1969; Robson, 1980; Mackay, 1984; Marinov, 2014; De Melo, 2011; Hosny, 2013). Therefore, our first chapter was theoretically enriched from **integration determinants in developing countries**, aimed to achieving the most appropriate approach in analyzing the integration effects in the case of Tajikistan.

One of the essential arguments of the current position of integration process in Tajikistan is its changeable directions. That means: Before 1991, only the Soviet Union had an important place within the integration ambit of Tajikistan, but after gaining independence and politic imbalance, Tajik integration initiatives involved other options with the same importance. It is noteworthy that although in terms of *market economy* the regional integration in Tajikistan does not have a long history, in terms of *planned economy* it is not a recent phenomenon, as the country was integrated with the great Soviet Union[1].

The ***second chapter*** provides a description and an analysis of the integration options or strategies followed by Tajikistan. Immediately after the dissolution of the

[1] It is interesting that in integration literature one can find very rarely about Soviet Union integration, mainly in some thorough books like "Regional Integration and Development" by Schiff and Winters (2003), where they discussed history of Regional Integration agreements with examples of the customs union of the provinces of France in 1664 or Germany (the Zollverein), but concerning the great Soviet integration, nothing.

USSR, the Tajik integration movement was winning favor not only with the Post-Soviet Republics in the frame of (CIS) or Central Asia region (CACO) but also join countries outside the Former-Soviet Union such as China (in the Shanghai Cooperation Organization, SCO), Iran, Turkey and Afghanistan (Economic Cooperation Organization, ECO), as well as with the global market organizations and international institutions like the UN, IMF or WTO. Since 2000, Tajikistan has been taking part in the Eurasian economic Community (EurAsEC).

Considering the integration initiatives followed by Tajikistan, we can suggest **three different options** or ways. First of all, an ambit of the integration process of Tajikistan has introduced the **post-Soviet initiative**, whose engine is Russia. There was also a Central Asian initiative, but it is not really possible to separate the Central Asian from the post-Soviet integration; therefore it can be proper taking the two sub-strategies in this option. In the line of the whole former-Soviet area, the first option involves agreements like the Commonwealth of Independent States, **(CIS),** and the Eurasian Economic Community, **(EurAsEC)**. The other sub-strategy of this option includes the Central Asian regional agreements like the Central Asian Economic Community, **(CAEC)** and the Central Asian Cooperation Organization, **(CACO)**.

Within the country's integration process, the role of the ***global market integration*** has been considerable, as it had fulfilled its primary objectives by providing a nationhood signal and proper financial assistance for this small less developed country. Therefore, at the multilateral level, the ***integration with the world economy*** or international financial institutions can be seen as a ***second option*** in the context of Tajik integration strategies.

Among the different integration initiatives followed by Tajikistan a especial mention should be given to the integration with ***outsiders of the post-Soviet Orbit***, mainly ***China*** and ***the Southern neighbors*** which are considered the agents that changed dramatically the geopolitical and economic position in Central Asia. In fact, China has quickly become a key player in the regional scene with its prominent ***Shanghai Cooperation Organization (SCO***). From this point of view, nowadays, the Central Asian region is recognized as the driving force ensuring a so-called "***peaceful rise of China***" (Goldstein, 2005).

Eventually, it is quite obvious that since Islam is the prevalent religion and given the geostrategic position of the country, Tajikistan is trying to strengthen its status in the

Islamic world. Hence, the participation of the country into a number of key institutions whose membership is based on the full or partial identification with Islam, like the Organization of Islamic Cooperation ***(OIC***) and Economic Cooperation Organization ***(ECO)*** is not excluded. From this stance, integration with outsiders of the post-Soviet Orbit, supported by China and the Southern neighbors are considered as a ***third option*** within the ambit of the integration strategy.

In short, the Tajik government has been everywhere in searching a successful integration project which includes both economic and political issues. After Soviet disintegration, Tajikistan together with other Central Asian countries faced a quite complex situation in the choice between several options (Pomfret, 2004; Tai and Lee, 2009; Kassenova, 2013). The country increasingly opened its economy and has developed different integration options in parallel, whether via agreements with traditional post-Soviet partners or within the international area or with the Southern neighbors like China and Islamic World. But, it seems that the agreement prioritized by Tajikistan in recent years is EurAsEC.

Along with a theoretical review of the economic integration processes and an evaluation of the particular integration process undertaken by Tajikistan, once we conclude that the agreement considered as more successful is EurAsEC, we carried out an empirical analysis of the effects of EurAsEC on Tajikistan. We confine our attention to the static effects of the integration process in chapter three, leaving the dynamic effects and other integration determinants, which are relevant for developing countries, for chapter four.

It is noteworthy that despite the relevance of *dynamic effects*, which influence the economic growth rate in medium and long terms, *static trade effects* (in terms of the theory of Viner-Meade-Lipsey) remain crucial determinants in the formation of integration agreements. In spite of the economic integration agreements increasingly cover a range of other issues like services, investment (FDI), joint industrial development and growing level of technology, the effects on the share of intra-regional trade and total regional trade remain important in determining the success of an integration agreement (Dee and Galli, 2003).

The ***third chapter*** firstly provides a review of the empirical analysis of the effects of regional integration, taking into account the different approaches with a special attention to Gravity Model. The empirical literature has shown that bilateral trade patterns are well

described by the so-called ***Gravity model*** drawing upon analogy to Newton's Law of Gravitation. This relates trade between two countries positively to both of their incomes and negatively to the distance between them. Moreover, historical, cultural and linguistic variables and a set of other dummy variables that measure the effects of preferential agreements will also be used in the present work.

In recent years, there are plenty of empirical studies regarding the effects of regional economic integration on trade flows. The approaches most commonly used in the empirical literature, especially in the most recent works, are the ***ex-ante studies*** that used ***Computable general equilibrium (CGE)***, (Deardorff and Alan, 1998; Brown et al, 2003; Robinson and Thierfelder, 2002, Piermartini and Teh, 2005; Hertel, 1997, 2006; Baldwin and Venables, 1995) and ***ex-post Gravity models*** (Anderson, 1979; Bergstrand, 1985; Deardorff, 1998; Soloaga and Winters, 2001; Rose and van Wincoop (2001); Glick and Rose (2001); Anderson and van Wincoop, 2003; Dee and Gali, 2003 Bergstrand and Baier, 2007; Yang and Martínez-Zarzoso, 2013). These two widespread approaches for the analysis of the effects on trade into the context of RTAs will be discussed in the third chapter of this work.

After the review of the empirical literature, in this chapter we do an ex-post estimation using a Gravity model, the *key ex-post econometric technique* according to Dee and Galli (2003). Regarding to the econometric method, while the early works used ***cross-section*** techniques for analyzing gravity models (Aitkin, 1973 and Berstrand, 1985), most recent studies used ***panel data*** (Matyas, 1997; Wall, 2000; and Glick and Rose, 2001).

Despite a number of empirical contributions in recent years, the effects of regional economic integration on trade in Tajikistan using the Gravity model under the panel data have not been investigated. Although we found a very thorough research by Vinokurov et al (2013) on the effects of regional economic integration on trade in Tajikistan under the country's accession into the Eurasian Customs Union, a **gravity model approach** was not used. This void motivates our study, which focuses on the trade effects of EurAsEC agreement for the area as a whole and in the case of Tajikistan in particular. To assess these effects, we estimate an augmented gravity model, including regional dummy variables, with panel data and fixed effect estimator techniques.

In a nutshell, our aim is econometrically test whether the agreement between EurAsEC countries increased trade flows between them and whether the agreement allows

for an increase in Tajikistan trade. In order to answer this question, by testing the model for a sample of 26 countries over the period 1995-2013, we analyze two determinants of static effects: **trade creation** and **trade diversion**.

We start **chapter four** showing a general overview of the Republic of Tajikistan. As previously mentioned, the "new integration theory" emphasizes that, in general, but especially in the case of developing countries the static effects are not sufficient or not relevant in determining the welfare effects of economic integration; then **dynamic effects** should be considered. Moreover, in the case of developing countries, there are **other integration determinants**, several factors determining the desirability of participating in an integration agreement beyond static and dynamic effects. Consequently, the target of this chapter is empirically determining all these aspects in the case of Tajikistan membership in EurAsEc. To meet these goals, this chapter attempts to grasp, on one hand, the *growth effects* and *foreign direct investment (FDI)* in Tajikistan as essential components in terms of **dynamic effects**. On the other hand, we evaluate some of the **welfare effects of integration for developing countries** that are not covered by traditional analysis for developed countries, as well as some of the **factors motivating developing countries to participate in an integration area** that could give rationality to integration of Tajikistan into EurAsEC at both the current degree and perhaps a deeper degree in the future. Following Marinov (2014), we differentiate three categories: general economic (development objective), market-related, and trade-related determinants. In addition to economic determinants, there are also several political incentives of economic integration that are of special importance to developing countries.

In addition to the static and dynamic effects, developing countries look for a **development objective** in join an integration agreement (Balassa, 1975). Aspects like **poverty alleviation** and improvement of **Human Development Index (HDI)** are the main components for improving the standard and quality of life; therefore, we analyze how these indicators developed after Tajikistan joins EurAsEC. Indeed, the Tajik government together with other developing countries participates into integration agreements or other international organizations, first of all, aiming at the outcome of the economic and political development under common projects such as poverty reduction programs, education and health challenges, infrastructure development as well as the promotion of peace and security within the country.

In regard to market-related determinants, we focus on the potential effects of integration in EurAsEc on **employment and productivity** and the **industry development** in Tajikistan.

Before analyses trade-related determinant we show Tajikistan's trade pattern performance, by sectors and by partner. After that, we turn to evidence on several **trade-related determinants** which are relevant in the case of developing countries, namely, **trade as a percentage of GDP**, **trade pattern with developed countries**, **intra-regional trade and total regional trade**, and **competitive versus complementarity countries**.

Since our interest lies mainly in the gains from integration, we review every differential impact of this process, including a number of **political factors**. Along with economic activities, political and economic institutions were also vital in maintaining peace and security and helping in transforming integration of the less developed countries in a way that soothes and heals the wounds of war and conflict, primarily in the case of Tajikistan.

Whilst Tajikistan as a less developed country shows interest in economic issues as an important step toward development, at the same time the country attempts to further promote regional integration under the peace and security issues. This is evident in some of the integration initiatives at different nature. In fact, given the geo-strategic position of Tajikistan, one of the main reasons of being member within the scope of several integration options is a political factor, as security issues that have been predominant issues of economic development, chiefly after the awful civil war.

With the limitation of the shortage of data for some of the variables (mainly for the labor market and transport cost), which is a common feature in dealing with less developed countries, we have widely discussed the traditional effects reached by Tajikistan under EurAsEC membership and several integration determinants, explaining the rationality of Tajikistan in join EurAsEC beyond traditional static and dynamic effects.

After this general introduction, the present thesis is based on four complementary building blocks and is organized as follows:

The ***first chapter*** reviews the literature of economic integration theory emphasizing two main approaches (*Traditional and New integration theories*) putting the accent on the effects of economic integration for the *developing countries*.

The ***second chapter*** introduces the *pathways of Tajikistan integration*, describing agreements involving the country in the ambit of several options.

In ***chapter three*** we estimate an *augmented Gravity model* using panel data to analyze the static trade effects of EurAsEC on the area and on Tajikistan, determining which one of these effects "trade creation" or "trade diversion" will prevail.

Chapter four complements the analysis with an assessment of the potential effects of integration on Tajikistan based on *some dynamic effects* and *main integration determinants* in the case of developing countries.

Finally, we conclude with a summary of the key findings and policy implications.

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Chapter 1

The Theory of Economic Integration

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Chapter 1.

The Theory of Economic Integration

1.1. Introduction

Globalization and regional integration processes are essential characteristics of today's world economy, which have been significantly developed after the 1950s. Accordingly, on the threshold of the XXI century a process known as "new regionalism" has emerged. Since the second half of the XX century, in a context of rapid economic growth, an intensive development of international trade in goods and services took place; the result was a number of commercial agreements between countries.

Following the Second World War, a few number of integration agreements were enforced, mainly in the developed regions of the world, but in recent years regional integration reached nearly all countries in all continents. Nowadays, most countries in the world, especially developing countries, take part in one or more Regional Integration Agreements (RIAs).[2]

Such generalization of the world experience shows that the dynamics and scale of foreign economic relations of national economies gravitate around neighboring countries. Such an orientation of the integration process is called regionalization. Then, it seems that geographical proximity adds weighty arguments in favor of regional trade and economic integration. However, the degree and forms of the union can vary greatly depending on the level of development of countries, their geographical location, historical traditions and complementarities of production structures. One of the important aspects of the present wave of economic integration is its shifting paradigm. The underlying motives for economic integration in the 1950s and 1960s were very different from those today. Current initiatives involving developing countries are part of a strategy to liberalize and open their economies to implement export and foreign investment-led policies rather than to promote import substitution (Bhalla and Bhalla, 1997).

[2] In June 2014, the WTO declared 585 RTA notifications, of which 379 were in force; 412 were made under Article XXIV of the GATT 1994; 39 were pure Regional Trade Agreements (RTAs); and 134 under Article V of the GATT, (WTO, 2014).

Given current developments of economic integration agreements, it has been more and more important to understand not only the rationale behind these arrangements but also their effects, particularly the impact on member states. The relevance of the economic integration has become a controversial topic for academics as well as for politicians. By reviewing the literature on economic integration, the aim of the chapter is to provide insights on what economic integration means, how the economic integration process takes place and, what it is more important, why countries engage in integration agreements, that is, the potential welfare effects of economic integration; in particular, in the case of developing countries.

In very broad terms, we can consider that economic integration emerges from eliminating barriers between groups of countries. During this process, countries remove a number of elements (or barriers) which made them differentiated and permitted them to protect their respective production systems. In doing that, these countries give each other special benefits which are not extended to third countries. Depending on these barriers which would be deleted, economic integration can take different forms or degrees; usually, following (Balassa, 1961), five degrees are considered. Furthermore, together with that negative way to integration (by removing barriers), it is also necessary a positive way to the integration process in terms of common institutions and policies, both of them being complementary, (Tinbergen, 1954).

Since the first step to economic integration and the most common forms of integration are the formation of a Free Trade Area or a Custom Union by reducing or removing barriers to trade flows, the expected gains of integration are firstly the gains from trade. However, economic integration does not take place at global level (multilateral liberalization of trade in the WTO context) but just including some countries (the members of the preferential agreement) in a discriminatory preferential process. So, the potential effects of economic integration cannot be fully explained by the international trade theory.

The first work analyzing economic integration effects was (Viner, 1950), concluding that integration has two possible effects on trade flows, with different effects on welfare: *trade creation* (trade shifts from a high-cost supplier member state to a low-cost supplier member state within the union; having a positive welfare effects) and *trade diversion* (imports are shifted from a low-cost supplier third country to a high-cost supplier member country into the union; implying negative welfare effects) (Balassa, 1975).

Viner's static analysis of the effects of a Custom Union constitutes the T*raditional Economic Integration Theory* (or *Old Regionalism*). His conclusion that the net effect of customs union formation on welfare is ambiguous caused a large number of further developments during 50's and 60's by, among others, (Kreps, 1950; Meade, 1955; Lipsey, 1957; Balassa, 1961-1975; Johnson, 1965; Cooper and Massell, 1965).

As early as in the 60's, the conclusion was that the static analysis in terms of trade creation and trade diversion is insufficient to capture welfare effects of economic integration and the Dynamic Effects analysis is introduced by the so called *"New Economic Integration Theory"* in the context of the *"New Regionalism Approach"* (Balassa, 1961; Hansson, 1962; Cooper and Massell, 1965a).

These dynamic effects influence the accumulation rate, transforming the productive structure to a more competitive and specialized one, and then raising the country's rate of economic growth over the medium term (Balassa, 1961, 1975; Abdel Jaber 1971; Baldwin, 1993; Schiff and Winters, 1998; Rueda-Junquera, 2006). The main dynamic effects are derived from economies of scale, technological progress and productivity growth, competition, reduced risk and uncertainty, a more favorable environment for economic activity, investment (and foreign direct investment) and innovation (Badinger, 2001).

When members of the integrated area are developing countries, although the new theory of economic integration is more appropriate than the traditional theory, the consideration of dynamic effects, as taken by the analysis of the integration of developed countries, do not explain adequately the welfare effects for developing countries.

The orthodox theory of Viner-Meade-Lipsey, centered on the static effects of resource allocation, is not appropriate to the case of developing countries (Meier, 1960; Balassa, 1965; Abdel Jaber, 1971; Mackay, 1984). So, the emphasis should be put on dynamic effects (Mikesell, 1965; Sakamoto, 1969; Abdel Jaber, 1971; Rueda-Junquera, 2006). The literature of economic integration theory was focused on integration of almost exclusively industrialized countries (Balassa, 1965). The assumptions of the basic theory do not conform to the economic preconditions and existing structure found in the developing countries, and the requirements for successful integration, as suggested by Traditional and New theories, are not usually fulfilled by developing countries (Mackay, 1984). The environment and difficulties of developed countries do not apply to economic development, rather than to a tariff issue and production/consumption shifts.

So, soon after Viner's contribution, in the framework of the new economic integration theory, a number of substantial researches have been done on the effects of economic integration agreements to less developed countries like, among others, (Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al,1969; Robson, 1980; Mackay, 1984; Marinov, 2014; De Melo, 2011; Hosny, 2013). These works are focused on the limitations of the traditional theory and the reasons why traditional approach is not sufficient or is not adequate in explaining potential economic integration effects (the welfare impact) in the case of developing countries, as well as the determinants that influence the motivation to participate in integration processes for these countries (Hosny, 2013 and Marinov, 2014).

In addition to production and consumption effects, welfare effects of economic integration between less developed countries should also encompass the positive effects of employment, productivity and income effects, production specialization, competitiveness, etc. (Abdel Jaber 1971; Mikesell, 1965). Regarding the determinants that influence the motivation to participate in integration processes, in the case of developing countries, these factors also go beyond the static and dynamic effects determining net welfare effect. Moreover, in general terms but especially in developing countries, not only economic factors but also a number of political factors determine the desirability and the success of an economic integration agreement (Allen, 1963; Inotai, 1991; Grossman and Helpman, 1994; World Bank, 2000).

After this introduction, the chapter is divided into two parts and is organized as follows. In the first part, in section 1 we discuss the concept of economic integration and in section 2 we analyze the different forms or degrees that an integration process can take. In the second part of the chapter, devoted to the analysis of the potential effects of economic integration, section 1 discusses the Traditional Economic Integration Theories; section 2 discusses the New Economic Integration Theories and section 3 focuses on the effects of the integration process in the particular case of the developing countries. Finally, we present the main conclusions.

1.2. The Economic Integration Process

We begin the review of the literature on economic integration by focusing on the meaning of the term "integration", in what is meant by economic integration and how this integration between independent countries takes place.

1.2.1. The concept of economic integration

The concept of "integration" has emerged and been added in the political dictionary since 1930s of last century (Sorokin, 2008), chiefly the famous theory of large spaces «Gross Raumtheorie» that developed by prominent German historian and jurist K. Schmidt. In this theory he pointed a weakness of the traditional nation-states in relation to the process of economic development in the XX century and came up with the idea of creating large geospatial as a new, more advanced and full subjects of international relations and international law.

Despite the variety of the contexts in which the concept of integration is used, nowadays the engine of integration processes is the "economic integration concept" (Sorokin, 2008).[3] However, the use of an integration concept in an economic sphere has a short history. Indeed, (Machlup, 1977) was unable to find a single instance of its use prior to 1940. In the same vein, (Jovanovic, 1998) claims that the economic integration as a term is not found nowhere, even in the old historical literature on the economic interrelationships between states, neither in the literature about customs unions (including the German Zollverein 1834-71), nor in the literature on international trade prior to 1940s.

Since then, the term has been used at various times to refer to practically any area of international economic relations. By 1950s the term has involved the amalgamation of separate economies into larger regions, however, it was in the more limited sense than the term is used today (El-Agraa, 1997).

1.2.1.1. Some definitions

The word "Integration" comes from the Latin term "integration", which means merging, combining parts into a whole. In the economic literature, the term "integration"

[3] The concept of integration is used not only in the socio-political context but also in scientific and technical fields.

does not have a clear-cut meaning. At one extreme, the mere existence of trade relations between independent national economies is considered as a form of economic integration; at the other, it is taken to mean the complete unification of national economies (Balassa, 1961). Similar to this, (Molle, 1994) argued that the expression "economic integration" covers a variety of notions: it may refer to the absorption of a company in a larger concern or it may have a spatial aspect, for instance if it refers to the integration of regional economies in a national one.

Since Viner's (1950), statement on customs union, the discussion about the concept of economic integration has started. In an attempt to define the different meanings of the economic integration, in the literature there are several definitions considering many different aspects which we can summarize as:

- *Myrdal, (1956):* the economic integration is "...the realization of the old Western ideal of equality of opportunity."
- *Balassa, (1961):* defines economic integration as "process" and as a "state of affairs."
- *Allen, (1963):"*economic integration may mean something different to nearly everyone.*"*
- *Tinbergen, (1965):* economic integration is "...the creation of the most desirable structure of the international economy, removing artificial hindrances to its optimal operation and introducing deliberately all the desirable elements of coordination or unification".
- *Kahnert, (1969):* Economic integration is "a process of the progressive removal of discrimination that exists along national borders."
- *Mutharika, (1972):* the term 'integration', literally means to bring parts of an object into a complete whole, while in economic terms, it would indicate, in the narrowest sense, the coordination of economic activities within a nation for the purpose of improving the development of that particular nation.
- *Machlup (1977):* integration is "a process of combining separate economies into a larger economic region" or "utilization of all potential opportunities of efficient division of labor."

- *El-Agraa, (1988):* economic integration is "discriminatory removal of all trade impediments between participating nations and the establishment of certain elements of coordination between them."
- *Carbaugh, (2004):* an economic integration is "a process of eliminating restrictions on international trade, payments, and factor mobility."
- *Molle, (1994):* economic integration is "the gradual elimination of economic frontiers between independent states; as a result the economies of these states end up functioning as one entity."

Some other considerations on the concept of economic integration: It is noteworthy the significant contribution of (Balassa, 1961) to the study of economic integration. He proposed differences between the concepts of "*cooperation*" and "*integration*" and suggested a dual interpretation of the category of integration: as the "process" and the "state of affairs". Moreover, (Balassa, 1961) distinguishes political and economic goals of integration and gives attention to the government role in some extent on the integration process. He also introduced the different forms of economic integration.

From a different point of view, the approach of Myrdal covers economic and non-economic aspects of integration, giving a more important role to the government on the regulation of international relations. According to him, " an economy is not integrated unless all lines are open to everybody and their reward paid for productive services are equal, regardless of racial, social and cultural differences" (Myrdal, 1956). In the sense that he has the main focus on the welfare of all members of an integrating group, he argued that complete liberalization of a market economy does not lead to the successful growth of countries, but instead it will lead to the divergence and inequality in incomes. He found a way toward disintegration. He admitted that "no liberalization of international trade can be expected by itself to change radically this situation of open international disintegration" (Myrdal, 1956), concluding that the process of "International disintegration" is one of the obstacles to the development of national economies in underdeveloped countries.

Furthermore, the term economic integration, as considered by (Molle, 1994), can be interpreted in two senses. In a static sense: when national components of a larger economy are no longer separated by economic frontiers but function together as an entity in the situation. In a dynamic sense: the process whereby economic frontiers between member states are gradually eliminated, with the formerly separate national economic entities gradually merging into a larger whole.

Moreover, (Mutharika, 1972) providing the integration term in a wider meaning, has referred to the process of integration as various economies in a given region joining together into a single unit with the objective of regional economic development. Other authors such as (Lawrence, 1996) distinguish between shallow integration and deeper integration: the first represented integration as trade liberalization while the second one goes beyond the removal of border barriers.

It seems clear that there is no a single and precise definition of economic integration. But, in general, we can consider that economic integration is to unify a number of different countries into a whole. These countries seek, firstly, economic benefits of this unification through improving the economic efficiency of production.

At any degree of integration, the economic integration process between certain countries implies a discriminatory trade liberalization which is against the "most favored nation" rules of the WTO and the general goal of multilateral free trade, which is assumed guarantying the optimum outcome (the *first best*) under certain assumptions. However, these types of agreements (which imply *second best* outcomes) are allowed, and they were allowed before by the GATT, as exceptions.

Whether regional agreements are complements to or substitutes for multilateral liberalization is a subject of ongoing debate. Some authors consider that regional agreements are barriers to multilateral free trade and they reduce welfare (Bhagwati and Panagariya, 1996). By the contrary, for others (Ethier, 1998) regional agreements led to multilateral free trade, improving welfare.

1.2.1.2. Positive and negative ways to integration

The term *"negative integration"* coined by (Tinbergen, 1954) refers to the removal of discrimination on the process of trade liberalization (by reducing trading limitations and tariffs) and elimination of restrictions in national economic rules and policies, leading to a "better division of labor" between countries (Tinbergen, 1965). The case of *"positive integration"* is related to the modification of existing instruments and laws or transfer to common institutions. So, the relevant aspect in positive integration is the creation of some institutional powers and new policies that allow the market of the integrated area to function properly and effectively as well as to maintain harmonization of broader policy aims of the union. All degrees of economic integration need some elements of positive integration, but the need is greater as the integration is deeper (El-Agraa, 2001).

On the one hand, negative and positive integration may go together and the balance between these aspects is a task that any integration agreement must face. On another hand, positive integration can come to play after customs union when requires coordinating joint actions. Thus, the question is to decide at what point of the stages of the integration process, institutions and single regulation are required, what led to Tinbergen proposing policy views for economic integration.

In the second edition of his work (Tinbergen, 1954) entitled "International Economic Integration" rather than "International Economic Cooperation" as the first one, he argued that in economic integration it is not correct to rely only on the market mechanism, claiming that only through the creation of a supranational body the integrated area can get positive welfare effects. Therefore, he states that the main need for the integrating area will be the formation of a *"supranational authority"*, concluding that the most general problem of economic integration is optimum economic policy.

Related with the different type of policies, he made distinction between qualitative and quantitative policy, considering that an important aspect of a qualitative policy is the choice between centralization and decentralization. (Tinbergen, 1965) tries to answer which functions of the international economic integration should belong to central and supranational control and which of them should be left to the local national structures, presenting four types of instruments "Supporting, conflicting, neutral and mixed", each of them having specific effects on economic integration.

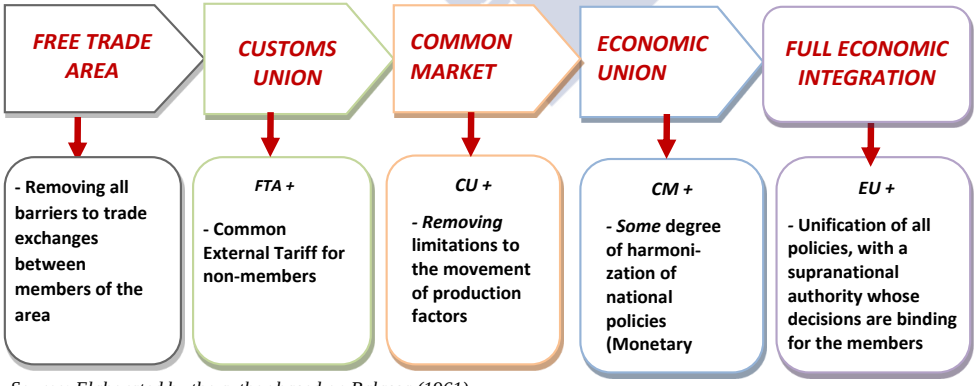
What is more, he formulated four conditions for the integration forms "consultation, coordination, agreement of lasting character and the strongest form being one supranational authority". According to these conditions, in each level of centralization, the role of joint policy should be stronger. (Tinbergen, 1965) came to the conclusion that countries have already developed effective international organizations which are involved in the supervision of the several basic spheres, including GATT (supervision and reduction of trade restrictions), IMF (supervision of the convertibility of currencies), FAO (regulation of agriculture and raw materials), ... While spheres like the supervision of spending equilibrium and employment policy are left to national governments and other, like regulation of migration, have no effective institutions.

1.2.2. Forms of Economic integration

Understanding the integration as a process and a state of affairs gives the importance to the classification of the different forms (or degrees) of economic integration. As (Hosny, 2013) claims, one cannot talk about the different forms of economic integration without mentioning the cornerstone work of Balassa. Therefore, in this work we follow mainly Balassa's classification (Balassa, 1961), considering five degrees or levels of integration (Figure 1.1).

Based on Balassa's classification, Molle (1994) outlined only three levels (like, for instance, (Tinbergen, 1954). Molle (1994) argued that transition between the various stages of integration is fluent and cannot always be clearly defined. The first stages seem to refer to market integration in a classical laissez-faire setting, focused on economic spheres. While other steps, especially the last two forms, entail more political integration. The duration of each level of integration depends on many different factors (internal and external, economic and political). Furthermore, El- Agraa, (1997) explained the final phase of integration as "political integration", with the implication that the decision about full economic integration, that is the unification of main policies (monetary, foreign, and social) leads to the significant loss of sovereignty. Besides this classification with five levels, (Baldwin and Venables, 1995; Panagariya, 2000; and Jovanovic, 1998) added a first degree of integration: the *Preferential Trading Area.*

Figure 1.1. Forms of Economic Integration



Source: Elaborated by the author based on Balassa (1961)

1.2.3. Degrees of integration

Preferential Trade Arrangements (PTAs): According to Panagariya (2000) , PTAs refers to a union between two or more countries in which lower tariffs are imposed on goods produced in the member countries than on goods produced outside. The term Preferential Trade Agreement PTA, used synonymously of Preferential Trade Area or Preferential Trade Arrangement, can be used to describe FTAs, CUs and arrangements involving partial trade preferences. Preferences, however, need not extend to all trade between the countries involved, and the coverage could depend on the type of PTAs.

Countries provide to each other more favorable trade regime than to third countries. Such discrimination of non- member countries is not according to the principle of "Most favored nation" but this kind of agreements was the result of expansion of the world economy and the world trade in second half of the 20th century. Indeed, the first Preferential Trade Agreements have been signed after the Second World War.

The ongoing integration of the European Union (EU), the formation of the North American Free Trade Agreement (NAFTA), as well as the political discussion about a possible preferential trade agreement (PTA) between the Americas or between NAFTA and the EU have been major sources for the renewed interest in PTAs in the last two decades. A key feature of theoretical models of PTA formation is that countries or country-pairs do not decide about PTA membership in isolation but their decision and behavior rather depend on other countries' actions. The formation of PTAs changes an outsider country's willingness to participate in a PTA. The establishment of a new preferential trade agreement (PTA) or the expansion of an existing one alters the incentives of non-members to participate in a PTA, leading to a domino effect (Larch and Egger, 2008).

In some way, a PTA is the preparatory step to the FTA and deeper integration forms because it involves the simplest form of an integration process. In the case of developing countries, since tariffs are still non-negligible, it is sensible to start with the efficiency or welfare effects of PTAs (De Melo, 2011). But, most integration projects remain at the stages of preferential trading agreements or free trade areas because this is the stage that requires less policy coordination.

Free Trade Area: Bhagwati and Panagariya (1996), following Balassa (1975), have interpreted FTA as the first form towards any integration project when tariffs and non-tariff barriers are eliminated among participating countries but each country retains its own

commercial policy against third countries. It is a form of "commercial integration".[4] More accurately, according with GATT, a Free Trade Area is interpreted as: *"For the purposes of this Agreement: (b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce …. are eliminated on substantially all the trade between the constituent territories in products originating in such territories."* Par.8, art. XXIV, GATT.

Basically, two criteria were laid down in Article XXIV for a FTA (or CU) to be granted waiver from MFN obligations: first, "substantially all trade" among members must be free, and second, post-agreement barriers on trade with non-members are not on the whole more restrictive than those that members had prior to the agreement.

Customs Union: The main difference from the previous form is the agreement about the gradual abolition of national customs tariffs that lead to the implementation of a common external tariff and an unified system of non-tariff regulation of trade towards the third countries. The GATT, in its article (XXIV), interprets a Customs Union as:

"For the purposes of this Agreement: - A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that (i) duties and other restrictive regulations of commerce ..... are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and, (ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union". Par. 8, art. XXIV, GATT.

Other authors had referred to the customs union as the first specific form of economic integration to be dealt with extensively in economic science (Robson, 1993). In fact, the customs union issue became one of the basic research topics for many authors addressing the economic integration topic (Viner, 1950; Tinbergen, 1954; Meade, 1955; Lipsey, 1960; Balassa, 1961) as we will discuss later. Balassa (1975) has defined customs union, apart from the suppression of intra- area trade barriers, including equalizing tariffs on imports from non-member countries. Moreover, Viner's definition stated clearly that the customs union is a free trade area which is complemented with a common external

[4] ASEAN (1967) or NAFTA (1993) are examples of this degree of integration.

tariff (Viner, 1950). Therefore, in this stage, the creation of coordination institutions of foreign trade policy will be important.[5]

Common Market: The third degree of economic integration implies the creation of a common market. A common market goes beyond a customs union, inasmuch as it also entails the free movement of factors of production (Balassa, 1975). If in previous stages integrating countries agreed only on free movement of goods and services, in this stage they should agree on free mobility of all production factors like capital, labor, technology and information. What is more, for the regulation of the integration process, member countries should develop and implement common economic, sectoral and trade policies towards non-member countries, upon the conditions of common institutions.[6]

The first analysis on the welfare effects of the movement of factors of production in an integrated area (Meade, 1955) concluded that free movement of factors can increase gains derived from the custom union, by reducing relative scarcities of the production factors.

Economic Union: In its turn, an economic union combines the suppression of restrictions on the movement of goods, services and production factor with some degree of harmonization of national economic policies, in order to reduce discrimination coming from national disparities in these policies, (Balassa, 1975).

In some case, the coordination is complete and refers to the more social aspects and involves the activities of supranational economic bodies. Supranational regulation implies intervention in various sectors of the economy, not only in the sphere of foreign exchange, but also in macroeconomic coordination. Therefore, the integration literature very often acknowledges this stage as "policy integration". Some authors distinguished the formation of Economic and Monetary Union as a separate stage of economic integration. Prominent and unique example of such an integration process is the current European Union.

Full Economic Integration: When integration area is at the stage that performed the full coordination of monetary policy, exchange rate policy, common currency reserves, single central bank and the implementation of a common currency for all countries, we can talk

[5] Some examples of this kind of integration are: ASEAN (1992), European Community–Turkey (1996), EurAsEC (2010)...

[6] Some examples of this kind of integration: MERCOSUR (1991), European Community (1993), Gulf Cooperation Council (GCC) (2008)

about a “full economic union”. In the next stage, the evolution of integration processes will be the complete integration of the countries, in other words “policy integration", meaning the loss of national sovereignty and assuming a common government.

According to Balassa (1975), total economic integration means the unification of economic policies, reaching a highest development point in the establishment of a supra-national authority whose decisions are binding for the member states. Full Economic Union is the most advanced type of economic integration where common market space converted into the holistic economic-politic union. Political union implies common internal and external policy, formation of a common legal base, as well as the development and adoption of a common constitution for all member countries of the Union. It should be noted that some authors do not include this form of integration in their classification of economic integration degrees.

Thus, economic integration historically has gone through several stages of development thereby creating certain forms that each has gradually evolved from the previous one.

Each step of integration can have place as the ultimate aim of integration, since it is not necessary to follow full economic integration as the eventual goal. In fact, an integration project may choose remain for a long time in one form of integration, like North American Free Trade Area (El- Agraa, 1997). Usually, integrated areas giving a particular name to their integration projects do not necessarily indicates their stages of integration, but only means the intention of states. For instance, a group calling itself an “economic union” might only be at the level of removing customs restrictions or sometimes they have not even reached the level of a free trade area (Kiriev, 1998).

Finally, it is noteworthy that economic integration cannot be a simple and unique process generally applied because the development model of the integrated group in developed countries differs from such model in developing countries or in transition economies. Most of the integrated regional areas, mainly for least developed countries, have not gone beyond the early stages, focusing the development of the agreements and the expected effects on the commercial integration.

2 Potential effects of economic integration

Over the last century, more than half of the world trade has taken place in the Trade Blocks in the framework of commercial integration agreements. The current globalization process in the world economy is expanding the possibilities of deeper integration, not only in the sphere of multilateral trade relations, but mainly in the different kinds of regional, sub-regional organizations and integration arrangements. In some way, in recent decades, the world economy has become more 'regionalized' and more 'globalized'. Apart from political reasons, when a group of countries decides to initiate an integration agreement, its economic reason is mainly increasing gains from trade and welfare of the participating countries. It is assumed that each member achieves this objective by exposing its economy to the competition with other economies of the integrating group.

The theoretical basis for the effects of economic integration were first derived from the international trade theory and the international economic relations fields, which means that it was developed by internationalists, not regionalists. But regional integration agreements are discriminatory; they do not imply multilateral or global free trade. So, the effects of the integration processes cannot be fully explained by the international trade theory. The first work identifying advantages and disadvantages of economic integration further than the international trade theory was Viner (1950) with a static analysis in terms of trade creation and trade diversion effects, referred to as "traditional economic integration theory". As early as in the 60's the conclusion is that the static analysis is insufficient (Hansson, 1962) and the Dynamic effects analysis is introduced by the so called "new economic integration theory" in the context of the "new regionalism approach", considering that economic integration processes provides an incentive to an effective use of economies of scale, increase the competitiveness, raise productivity, investment climate, and technological transfer.[7] In their review of the economic integration

[7] In any case, regional economic integration agreements are a trade policy and, although in the last two decades there was a shift in the focus of international trade research from trade policy to other forms of trade frictions (transportation, information and communication costs), trade policy is still matter (Goldberg and Pavcnik, 2016). In this work, they show a large evidence on the effects of trade policy on economically important outcomes that include: (1) aggregate outcomes, such as trade volumes (price and quantity subcomponents), the extensive margin of trade, and static, aggregate gains from trade; (2) firm and industry performance (productivity, costs, and markups); (3) labor markets (wages, employment, and wage inequality); and (4) long-run aggregate growth and poverty, secondary distortions and misallocation, uncertainty.

literature, (Baldwin and Venables, 1995) organized economic effects of regional integration into the types below:

- **Static allocation effects**, consists of integration agreement's impact through the *static* allocation of resources, in setting models with both perfect and imperfect competition: Trade creation/trade diversion effects, procompetitive effects and effects for Economies of Scale and the variety of products.
- **Accumulation effects** which encompass effects of the integration agreement from the accumulation of productive factors and cover both medium and long term growth effects (*dynamic* effects).
- **Location effects**, related to the spatial allocation of resources (*dynamic* effects).

The second half of the twentieth century presented unprecedented progress in regional integration agreements, especially in developing and least developed countries. This led to theoretical interest in dealing with the effects of economic integration for this group of countries (Sakamoto, 1969; Jaber, 1971; Balassa and Stoutjesdijk, 1975; Hosny, 2013; Marinov, 2014). In result, along with these two static and dynamic approaches, the third type of integration theories appeared with a special emphasis on the case of developing countries.

Thus, in terms of potential effects of commercial integration, the rest of the section is organized as follows: in the first place, we will present the literature on the traditional economic integration theory, beginning with the main theories of the international trade which explain the gains from trade. Secondly, we will discuss “new regionalism approach”, with particular attention to the dynamic effects including investment, innovation, and technological progress. Finally, with the purpose of finding the most appropriate approach for the effective integration in the case of Tajikistan, we will focus on the integration determinants in developing countries.

2.1. Traditional theories of economic integration: Static effects

Baldwin, (1993) divides the potential effects into "static" and "dynamic effects". Nevertheless, he concluded that static efficient effects are at the root of all dynamic effects; so it is essential discussing them and estimate their magnitude before turning to dynamic effects. According to Baldwin, (1993) static effects “lead to more output from the same

amount of inputs, where inputs include physical capital, human capital, knowledge capital (technology)". Although the channels through which integration may affect static efficiency are various, the basic theme running through most is that removing all artificial market barriers allow market forces to play more freely across borders and within borders.

In summary, static effects arise from three main sources: lower trade costs, increased competition and enhanced factor mobility. The market liberalization involved in closer economic integration can improve the efficiency of productive factors, allowing for greater output from the same inputs. Presuming that the 'invisible hand' is an efficient taskmaster, this will lead to a more efficient resource allocation.

2.2. International Trade theory. Gains from trade

The immediate consequence of an economic integration agreement is associated with gains from trade, which the member countries expect from its early stages after the removal of trade barriers. The trade gains were the main focus in international trade theory and have been explained by different approaches. In static perfectly competitive models (based on comparative advantage principle), the gains from trade stem from the increased efficiency of resource allocations and improved consumption possibilities. Under increasing returns and product differentiation, in an imperfectly competitive context (New trade theory), international trade relaxes the trade-off between economies of scale and product diversity**.**

In "The Wealth of Nations", Adan Smith concludes that international trade leads to advances in productivity. International trade increases the size of the market and the largest market size allows greater specialization and division of labor, which promotes the growth of productivity and efficiency. Trade will bring economic benefits if goods are imported from a country where the cost is absolutely less and exported the goods of which the cost in this country is lower than abroad. The removing of barriers and the expansion of international exchange leads to an increase specialization of the national economies and their interdependencies, which in result improves allocation of resources.

The Adam Smith's analysis in terms of "absolute advantage" becomes the starting point in the theory of "comparative advantage" of Ricardo. The prominent Ricardian's (1821) model has a great contribution to the trade theory through its first demonstrated

positive effects of trade. While Smith´s absolute costs model has resulted into resource allocation effects, the Ricardian's comparative advantage (based on differences in technology) and the Heckscher-Ohlin-Samelson theory (based on differences in factor endowment) led to efficient resource allocation effects.[8]

Ricardo demonstrated the remarkable result that both countries can gain from trade if their (constant) labor input ratios differ, even if one country had an absolute advantage in both goods. Although obviously important and theoretically robust, the existence of gains from exchange is fundamentally a precondition of economics, not a testable implication of a particular model. The observed terms of trade are bounded between the comparative labor cost ratios of the two countries. The existence of gains from market exchanges is a theoretically sturdy result, derivable from different assumptions. But the Ricardian link between comparative cost ratios and the terms of trade is quite fragile, hardly surviving even the generalization to the multi-good case. Moreover, any serious attempt to study the determinants of relative product prices would surely allow for other inputs, including physical and human capital (Grossman, Rogoff and Kenneth, 1995).

Moreover, if comparative advantage theory from Ricardo has first shown positive effects of free trade, the Heckscher-Ohlin, (1933) theory would have been the first theory of international trade showing a positive effect on welfare. This means that, in order to maximize welfare, all artificial barriers between economies, such as tariffs and quantitative restrictions, need to be reduced. International trade theory ranging from autarky to free trade has explained that the involved countries tend to maintain production specialization due to their comparative advantage which leads to increase trade flows and efficiency. All this leads to trade growth that eventually enhance economic integration, including falling transportation costs, rising incomes, and declining tariff and non-tariff barriers. Usually, the formation of an integrated area (a Custom Union, for instance) eliminates inefficient domestic production, by allocating to each country the production of goods in which they have comparative advantage, improving the allocation of resources. This is the concept of industrial complementarity. In such case, trade enhanced refers to the inter-industry type: trade of goods belonging to different industries, which require for their production different factor intensity and that were produced and interchanged in the context of perfect

[8] In the H-O-S explanation, a country will have a comparative advantage in (and tend to export) those products which require production factors that are relatively abundant (and relatively cheap) in this country.

competition. The gains derive through better utilization of comparative advantages, will be greater when integrating countries are more "different" and their productive structures are more complementary.

This theory has dominated the theoretical arguments of international trade for a long time. Economic integration was seen as a step towards free trade. But this vision nevertheless disregards the effects of economic integration on non-members countries (Robson, 1980).

The *traditional trade theories*, explaining the patterns of trade and the gains from trade based on the difference between the supply side of the countries (technology or factor endowments), giving them a comparative advantage in the production of different goods, dominated the theoretical explanation of international trade until the 70's.

The New trade theory, developed among others by Krugman, (1979), Lancaster, (1980), Grossman and Helpman, (1991), emphasizes long run productivity effects of trade in the framework of scale economies and imperfect competition. In regard of imperfect competition, Baldwin, (1993) has submitted that in static models additional trade gains may result from the increase of returns to scale which firms realize as internal scale economies as well as from the increase of product and input variety for consumers and producers respectively. At imperfect competitive markets, trade liberalization can affect firm-stage variables, like size and productivity. Such static gains make a one-time change in the quantity of aggregate output not in its quality. These effects are at the core of the welfare insights emanating from basic trade theory.

Further, in the case of an industry marked by imperfect competition, Venables and Smith, (1988) have used simulation analysis to show that lowering even modest barriers leads to a substantial rise in the degree of competition. The result of the reduction in the monopoly pricing power of firms leads to lower prices and a more efficient allocation of resources. According to Krugman, (1979) static models of monopolistic competition and economies of scale suppose two sources of gain from international trade: First, opening up for trade among two states which produce differentiated products implies that there are more varieties available for consumption. This is a source of consumer benefit. Second**,** the increased competition lowers the equilibrium prices, as the large size of the market allows firms to realize economies of scale. The lower prices raise real wages, which lead to another source of consumer benefit.

Moreover, Baldwin and Venables, (1995) suggested that the welfare effects of an RIA (regional integration area) might be many times larger if industries are imperfectly rather than perfectly competitive and, in fact, much of the literature on RIAs for the last two decades has focused on environments that are imperfectly competitive. Models of imperfect competition and increasing returns to scale determine benefits from trade liberalization in the form of effects on output, scale, and variety. While this is a focus shared by much recent trade theory it is particularly important for the analysis of regional integration for two reasons. The first is that integration has occurred between economies with similar structures and large volumes of intra-industry trade, (in fact, European developments have motivated a good deal of this research). The second is the possibility that there is an interaction between market structure and gains from integration. Certainly, the "pro-competitive" effects of regional integration have figured prominently in such debate (Krugman, 1995).

In this case, trade enhanced refers to the intra-industry, interpreted as “the simultaneous export and import of differentiated products“ Parjanne, (1989) and Hansson, (1989). The vertical intra-industry trade can be defined as "the simultaneous exports and imports of goods classified in the same sector but at different stages of processing" (Krugman and Obsfeld, 2000). Consequently, the widest explanation of intra-industry trade applies to the horizontal differentiated goods (all varieties have the same quality) belonging to the same industry, where each variety is produced under increasing returns in a structure of monopolistic competition (Krugman, 1979; Lancaster, 1980; Helpman, 1981). Apart from product or horizontal specialization, there are possibilities for vertical specialization by subdividing the production process among individual establishment in the integrating group. As sales of the final product increase, different parts may be manufactured in separate plants, each of which enjoys economies scale, thereby resulting in cost reductions (Balassa, 1975).

Although imperfect competition has been assumed in many numerical simulations, the theoretical literature on RIAs does not provide a unified treatment of imperfect competition (Baldwin and Venables, 1995). In any case, when the market is imperfectly competitive, the increase in its size takes on a new dimension.

2.3. The Static Effects of Economic Integration

2.3.1 The Viner's contribution: Trade Creation versus Trade Diversion

Modern regional integration theory began with (Viner, 1950) under the name of customs union theory. The Viner's most famous result that the net effect of customs union formation on welfare is ambiguous caused a flood of works.[9] The so-called Viner's "static analysis" distinguishes two possible effects of economic integration on trade flows, with different effects on welfare: trade creation (which has positive welfare effects) and trade diversion (implying negative effects). "In the first case, there is a shift from domestic to partner country sources of supply of a particular commodity, in the second case, the shift occurs from non–member country to partner country sources of supply" (Balassa, 1975):

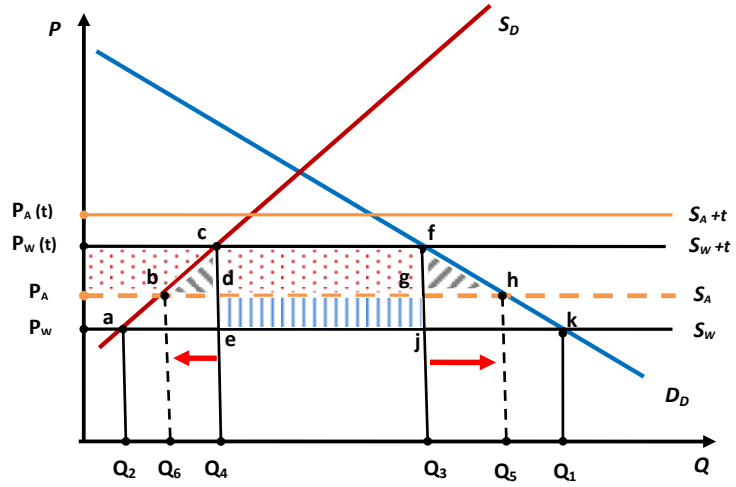
"*The primary purpose of a customs union and its major consequence for good or bad is to shift sources of supply, and the shift can be either to lower - or to higher- cost sources, depending on circumstances*".

Trade creation occurs when a group of countries enter into a trade agreement, and trade shifts from a high-cost supplier member state to a low-cost supplier member state within the union. It is welfare improving because it results in a better allocation of global resources and represents a step in the direction of free trade. By contrast, *trade diversion* can take place when imports are shifted from a low-cost supplier of a non-member country of the union (third country) to a high-cost supplier member country into the union. It is a less optimal allocation of global resources. It is welfare reducing and a step towards protectionism.

The process of trade creation and diversion can be illustrated by figure 1.2, by assuming three countries (Kreps, 1950): D (the home country), A (the potential partner), and W (the rest of the world).

[9] Most of these assumed perfect competition and constant returns and they illuminated special cases where total welfare effects can be signed, despite the fundamental second-best nature of RIAs (Baldwin and Venable, 1995).

Figure 1.2: Trade Creation and Trade Diversion Effects



Source: own elaboration

The curves $\boldsymbol{D_D}$ and $\boldsymbol{S_D}$ correspond to the curves of demand and supply of certain importing goods for the home country (D). Before integration, countries are trying independently to exploit their comparative advantage. Hence, in this case for home country D, the trading partner would be the rest of the world, where the price is lower (equalizing the lower cost of production) than in country A. Home country produces Q_2 and it imports Q_2Q_1 from W.

If home country applies a general tariff (t) on imports, domestic production increases (Q_4) and imports decreases (Q_4-Q_3), which led to a welfare decrease represented by the area of the triangles (a c e) and (f j k), (the decrease in consumer surplus is higher than the increase in producers surplus plus the government revenue). Suppose now that the home country D and country A decide to become an integrated area (FTA or Customs Union). So, they remove all trade barriers between them but they do not with the rest of the world. Then, domestic production decreases (Q6), domestic imports increases (Q_6Q_5) and imports come from the higher cost country, the partner (A).

Comparing this one with the above situation, the quantities (Q_4- Q_6) and (Q_3- Q_5) represent *trade creation*, while (Q_3-Q_4) corresponds to *trade diversion*. Net effect for welfare would be the sum of the positive effects from trade creation (b c d + f h g) and the negative effect of trade diversion (d g e j). The trade creation will be more significant

when initial tariff of members of FTA or CU is relatively high on imports from the rest of the world representing the differences in the cost of production.

As we see, trade diversion occurs when discriminatory tariff liberalization leads private agents to import from a supplier that is not the lowest cost source, thereby reducing home welfare by raising the nation's cost of consuming such goods. Clearly, trade diversion can arise from discriminatory agreements, but not under MFN tariff reductions. In any case, if bilateral tariffs are reduced only on imports from countries that already are the lowest-cost supplier, trade diversion does not occur[10]. According to Balassa, (1961) in a free trade area, maintaining different tariffs among member countries on the products of non- members introduces the possibility of trade diversion. Furthermore, production and investment diversion may occur if one admits trade in intermediate products. The diversion of trade, production, and investment represent unintentional effects of free trade areas. To avoid this, member countries of free trade areas have imposed "country of origin rules."

Thus, according to the Viner's approach, countries would have motivation to participate in integration processes if they bring more benefits (trade creation) than costs (trade diversion). The Viner's (1950) general conclusion is that Customs Unions are unlikely to provide a net trade creation unless strict circumstances such as that the agreements are "*...between sizable countries which practice substantial protection of substantially similar industries*".

2.3.2. Developments of the Viner's analysis

The Viner's work was reviewed by many researches since the 50's, adding on to his static analysis and contributing to the economic integration theory in different aspects. We will focus on the studies of Kreps, (1950); Meade, (1955); Lipsey, (1957); Balassa, (1961-1975); Johnson, (1965) and Cooper and Massell, (1965).

According to Meade, (1955), Viner's analysis only apply if demand is inelastic and supply is completely elastic. Assuming this, Meade states that a customs union may increase the volume of trade even though there is trade diversion, due to the increase in the elasticity of demand. He claims that in the case of adding this effect (named **"trade expansion"**) to the traditional Viner's effects, trade diversion may not be so adverse.

[10] This observation motivated the claim by Lipsey (1957) that RIAs are likely to be beneficial if the RIA partners initially account for large shares of each other's imports, as would be the case if they were low cost producers.

Lipsey (1957) stays that Viner's analysis was focused only on the production effects, losing sight of consumption effects, concluding that "...when consumption effects are allowed, the simple conclusion that trade creation is "good" and trade diversion is "bad" would no longer be valid". The changing relative prices in the domestic market of participating countries after the creation of the customs union have two effects: a **production effect** (as Viner's effects) and a **consumption effect** (the response of consumers to the drop in import prices). Trade creation and trade diversion may show production effects but they cannot be used to conclude the welfare effect of a custom union.

The distinction between production and consumption effects does not imply the absence of interaction between the two. Substitution among sources of supply will affect the pattern of consumption through changes in the prices paid by the consumer.

Lipsey (1960), by reviewing his previous article related to "production and consumption effects" comes to a more satisfactory conclusion in terms of the difference between **"inter-country substitution"** (one country is substituted by another, like in Viner's analysis of trade creation and trade diversion) and **"inter-commodity substitution"** (one commodity is substituted by another).

In some extent, Johnson, (1975) has disagreed with Viner's investigation and has suggested that trade diversion can increase welfare taking into consideration production and substitution effects, that is, the welfare losses caused by trade diversion may be more than outweighed by the welfare gains resulted from the removing of import tariffs.

In the Viner-Meade -Lipsey analysis, the participation in a trade-creating customs union was considered as a means to reduce the distorting effects of the country's own tariffs. According to Balassa, (1975) this argument was carried to its logical conclusion in contributions by Cooper and Massell, (1965a) and Johnson, (1965) who suggested that participation in a customs union is inferior to the unilateral elimination of tariffs, which leads to greater trade creation without giving rise to trade diversion.

Lipsey and Lancaster (1956-1957) distinguished between **"small and large tariff reduction"**, arguing that a small tariff reduction can increase welfare while a large reduction can increase it or lower it. Taking into account the integration stages, they found that in the initial tariff reduction welfare increase, but in the later steps decrease. Also De

Melo, Panagariya and Rodnik, 1993 have proved that small tariff reductions positively affect welfare more likely to large reductions.

Lipsey (1960), as Viner (1950) before, considers the welfare implications of **differences in production structures between the participating countries**. They have claimed that if a production pattern of the participating countries is competitive (less complementary) the chance of arising gains between member countries would be greater and welfare will increase. In a similar way, (Meade, 1955) concludes that for the increase of welfare, participating countries should be potentially complementary but actually competitive. On the other hand, (Sheer, 1981) stresses that welfare gains from customs union formation would be larger as member countries are more competitive. The gains will be larger as more dissimilar are the relative prices of protected products in the member economies and more similar these relative prices in other economies. Moreover, the gain will likely be larger if the initial tariff barrier is greater. Finally, gains will be larger when the products of prospective member nations and other nations are less substitute.

According to the Heckscher-Ohlin (H-O) model, countries with different factor endowments and different per capita income are expected to have larger trade flows and larger welfare gains after integration (Hosny, 2013). Related with this, Linder, (1961) and Sakamoto, (1969) argued that H-O model, while apply for natural-resource intensive products, like agriculture, does not hold for manufacturing products. Thus, in contrast to H-O conclusion, Linder's findings were that **countries with similar per capita incomes** (which will develop similar industries) enjoy more potential trade (in differentiated goods) than **countries with different per capita income**.

The issue of trade between countries of similar or different per capita income is related with the concepts of **intra-industry and inter-industry trade**. Pelzman, (1978) and Greenway,(1981) have argued that the traditional customs unions theory has concluded that inter-industry specialization is what drives the trade integration. Unlike this view, recent empirical researches show that intra-industry specialization is a driving force Hosny (2013). The greater the similarity of per capita income between potential trade partners, the greater the scope for intra-industry trade (Lancaster, 1980; Greenway, 1981). On the other hand, intra-industry trade tends to fall between countries with different factor endowments. So, Hosny (2013) has suggested that the increase or decrease in trade flows among

participating countries will be determined by similarity of per capita income and the pattern of trade, whether it follows the lines of inter-industry or intra-industry flows.

Given any country's trade volume, welfare gains from integration are more likely as higher is **the proportion of trade with its partner** and as lower **the proportion with the rest of the world** (Lipsey, 1960; Bhagwati, 1971). On the other hand, countries more likely to benefit from integration are those with lower **foreign trade as a percentage of GDP**. Lipsey, (1960) suggested that the welfare effects of a customs union will depend on the relative importance in home consumption of goods produced domestically and imported from non-member countries prior to the establishment of the union.[11]

Finally, Krauss (1972) stays that the consideration of the **effects on the terms of trade** alter the perspective of the welfare impact of economic integration and that this is always the case even for a small country. He disagreed with the assumption that if the considered country is a small country, it has no effects on world prices, suggesting that this may not always be true.

From the analysis of (Viner, 1950) we can conclude that the size of welfare effects relies on market structure variables such as the elasticity of demand and supply, and the geographical proximity of members. Further, CU policies could have an important impact on trade creation and diversion: allowing more countries to participate in an agreement and decreasing outside tariffs on imports from non-member states are two substantial policies that contribute to trade creation and welfare growth.

Balassa, (1975) also widely discussed the welfare effects of the customs union, concluding that in the abstract one cannot make a judgment as to whether establishing a customs union will increase or reduce welfare. Nevertheless, a consideration of certain factors may provide a presumption as to the possible direction of the welfare effects of a union. He suggested that the net welfare effects of the customs union will depend on the amount of trade created and diverted as well as on differences in unit costs[12]. The welfare

[11] Ceteris paribus, the larger the share of domestic goods and the smaller the share of goods imported from non-member countries, the greater is the likelihood of an improvement in welfare following the union's establishment. Such will be the case since substitution of partner country products for domestic products entails trade creation and their substitution for the products of non-member countries involves trade diversion (Balassa, 1975).

[12] In a partial equilibrium framework, under constant costs, there will be a welfare gain (loss) if the amount of trade created, multiplied by differences in unit costs between the home and the partner countries, exceeds (falls short of) the amount of trade diverted, multiplied by differences in unit costs between the partner and the non-member countries.

effects of a customs union will also depend on transportation costs. Along with other conditions, the lower are transport costs among the member countries, the greater will be the gains from their economic integration. Thus, the participation of neighboring countries in a union, with greater possibilities for trade creation across their borders, will offer advantages over the participation of faraway countries that tend to promote trade diversion.[13]

Applying the argument that gains are obtained through the enlargement of a union because of increased possibilities for the allocation of production, it also follows that the gains are positively correlated with increases in the market size of the participating countries (e.g. small countries will gain more from participation in a customs union than large countries). These propositions are consistent with Tinbergen's (1957) conclusion that increases in the size of a customs union will increase the probability of favorable welfare effects; in the limiting case, the customs union includes the entire world, which is equivalent to free trade.

Thus, after the review of the Viner's pioneer work and further developments, we can conclude, as Meade, (1955), that "our main conclusion must be that it is impossible to pass judgment upon customs union in general. They may or may not be instruments for leading to a more economic use of resources. It all depends upon the particular circumstances of the case."

In summary, we could expect that the net effect of an customs union would be trade creation (and welfare gains) when the integration takes place between countries for which the intra-area trade was important, they have a similar level of development, they set a low CET and for which its proximity implies low transportation costs.

2.4. New Regionalism approach: Dynamic effects

The economic integration may not only cause "static effects" but also a variety of potential "dynamic effects" which in the scope of the *new economic integration theory* has an important stance. Static analysis in terms of trade creation and trade diversion is not

[13] When initial tariffs on intra-RIA trade, but not extra-RIA trade, are in the neighborhood of zero, an increase in tariff revenues on external trade is a necessary and sufficient condition for welfare gain. Maybe a small country ought to prefer unilateral trade liberalization to membership of an RIA (Johnson, 1965; Cooper and Massell, 1965b).

enough to capture welfare effects of economic integration and Balassa, (1961) introduces the "dynamic effects analysis":

"Static efficiency, however, is only one of the possible success criteria that can be used to appraise the effects of economic integration. Instead of limiting our investigation to a discussion of efficiency in resource allocation under static assumptions, greater attention should be paid to the impact of integration on dynamic efficiency."

Cooper and Massell (1965a) agree with Balassa that static analysis is insufficient for assessing the welfare in the integration process, and they make the further point:

"*the static analysis fails to show why a CU may be acceptable when a tariff reduction is not, and it fails to analysis how a CU may more efficiently serve the ends previously served by non-preferential protection*"

In his comprehensive theory on economic integration, Balassa removed the static assumptions in order to discuss the impact of an enlargement of the size of the market on the long term. Therefore, "dynamic effects" of economic integration is where Balassa makes a real contribution to the discourse on economic integration (Ingram, 1962).

These dynamic effects will be long lasting or anything that affects the country's rate of economic growth over the medium term (Balassa, 1961; Schiff and Winters, 1998). In the same line, Baldwin, (1993) defines "*dynamic effects are those that influence the accumulation of factors, again broadly defined*" and consequently, affects the growth in per-capita income.

According to Balassa (1961), these dynamic effects are rooted in internal and external economies of scale, faster technological progress and productivity growth, enhanced competition, reduced risk and uncertainty, the creation of a more favorable environment for economic activity, increasing investment and lower costs of capital due to the integration of financial markets. More recently, special emphasis has been placed on the role of foreign investment and innovation in regional integration effects on long-run growth (Badinger, 2001).

On the other hand, Marinov, (2014) summarizes the dynamic effects of economic integration as follows: increase of investment expenditure; sustainable increase of demand; consolidation of production and increase of its specialization; improvement of the organization and management of production and production technology; rationalization of

territorial distribution and utilization of resources; increase of production efficiency; creation of economic growth, etc.

According to Baldwin and Venables, (1995), the integration process will be successful when there is a positive effect on dynamics of the innovation and technical progress, especially the so-called *"accumulation effect"*-as integration effects should be on the variables relevant to the determinant process of integration (physical capital, human capital and knowledge) and on the growth rate of the relevant variables for welfare.

Since the rate of capital accumulation depends on the costs and benefits of investing in human, physical and knowledge capital, for influencing growth, economic integration must affect these costs and benefits. Further, a side effect of this improved efficiency is an improvement in investment climate in the integrating region. This in turn will result in a higher investment rate, thereby augmenting the initial output gains by providing the economy with more resources. The same sort of induced capital formation can also boost investment in human capital and knowledge capital, which leads to technological progress and innovation.

Dynamic analysis of the effects of economic integration was developed in parallel with the changes in the economic environment and global conditions, like the increasing relevance of the service sector (as percentage of trade and GDP), the private sector participation (private firms supporting integration) or foreign direct investment (with rising importance of FDI in services like banking, advertising or transportation) (Lawrence, 1997).

In regional economic integration literature, the Vinerian analysis and its developments, focused on static effects, is called **"*Old Regionalism*"** while analyses focused on dynamic effects are called **"*New Regionalism*"** (El-Agraa, 1988; De Melo and Panagariya, 1993; Lawrence, 1997; Burfisher et al., 2004; Bhagwati, 1993). To name the same approaches, some authors refer to "first regionalism" and "second regionalism" Bhagwati,(1993); "short-term" and "long-term" concepts Panagariya, (1999); "traditional and non-traditional aspects of regionalism" De Melo, (2011) or simply "static" and "dynamic" concepts or the "traditional theory and new developments" (Panagariya, 2000).

Moreover, Burfishe et al., (2004), in their discussion about new and old regionalism, have characterized the new regionalism by many elements in the deepest level of integration. In addition, they have found a link between new regionalism and developing

countries, claiming that in most cases recent regional trade agreements have been created among developing countries and one or more developed countries partners.

Dynamic effects, which transform productive structure to a more competitive and specialized one, have an impact on the rate of members' growth Balassa (1961; 1975). First, the liberalization of the integrating area leads to increase market size and give a wide opportunity to the use of production capacity which in turn leads to economies of scale and a reduction in the economy costs. Secondly, the expansion of integration ties between countries improves the production and nonproduction infrastructure, which reduces costs related to the export and import transactions. Third, joining the integration unions usually entails increasing investments flows and quickens technological development in the economy of participating countries.

In summary, following Jaber (1971), the production effects of the static analysis of economic integration are concerned with changes in the production mix on a given Production Possibilities Frontier (PPF). Dynamic effects may lead to a higher growth rate and exploitation of unused economic capacities leading to a shift of the PPF itself.[14]

Economies of scale. The economic integration by increasing market size can allow an increasing exploitation of economies of scale as production volume increases, and to reduce production costs. Corden, (1972) first analyzed the implications of economies of scale for customs union theory in the terms of two effects: as a positive welfare effect, "cost reduction effects", and as a negative welfare effect, "trade suppression effect". The first refers to reductions of the average costs in inputs per unit, when domestic output expands after the formation of a CU. The second refers to the import replacement of more efficient producers from non-members by the less efficient domestic producers under economies of scale. So, Corden concluded that when economies of scale are allowed in an analysis of static welfare, "trade creation/trade diversion" concepts should be supplemented by the new concepts of "cost reduction" and "trade suppression" effects. From a different point of view, Krauss (1972) claimed that the effects of the economies of scale "should be accommodated by extending the definitions of trade creation and trade diversion not supplementing them."

[14] However, the dynamic analysis presents inconvenient at empirical level: while the static analysis has reliable general methods to estimate welfare effects of integration that is not the case for the several dynamic effects. We addressed this issue in the second part of our work.

Economic integration may lead to lower costs through increases in the volume of plant output, but plant size and unit costs are not necessarily correlated in the case of multi-product firms (Balassa, 1975). In such cases, costs may be lowered by reducing product variety through specialization in the integrated area. Apart from product or horizontal specialization, there are possibilities for vertical specialization by subdividing the production process among individual establishments in an integrated area.

An alternative approach to analyzing the implications of economies of scale consists on combining with imperfect competition and, often, product differentiation. Some of the key applications of this category of models have been developed in the context of issues such as the welfare implications of a simultaneous division of the world into several trade blocs and the expansion of a bloc through addition of new members, (Panagariya, 2000). Baldwin and Venables (1995) discuss the implications of imperfect competition and scale economies in the three-country framework, but while these authors carefully discuss the scale and cost effects of FTAs, identifying the relevant channels, they do not explicitly derive the welfare effects.

The economies of scale typically have their origin in the existence of fixed costs. In many cases, these costs are due to technological factors, especially the high costs of research and development (R&D). When products are differentiated, marketing also can turn to an important fixed cost. As a result, sectors of high technology and differentiated products generally present economies of scale. Moreover, the effect of the increase in integrated market size, taking advantage of economies of scale, becomes more important when the type of the intensified trade is intra-industry trade (IIT); since, as we have seen, the most widespread explanation of IIT is the one which referred to the horizontally differentiated goods trade, where each variety is produced under increasing returns in a framework of monopolistic competition.

Competition. The elimination of trade barriers creates the conditions for more effective competition of the domestic producers with those from the rest of the integrating area, which reduces the market power of domestic firms (Scitovsky, 1958). By increasing the number of firms, each producer considers, in the same way as his competitors, that the opening of national frontiers will contribute to the loosening of monopolistic and oligopolistic market structures in the individual countries. At the same time, there is no contradiction between gains from economies of scale and increased competition, since a

wider market can sustain a larger number of efficient units (Balassa, 1961). Greater competition may have beneficial effects through improvements in manufacturing efficiency as well as through technological change (Balassa, 1975).[15]

Krauss (1972) suggests that the gains obtained by increased competition and economies of scale can be achieved with unilateral trade liberalization. In this case, domestic producers suffer from the discipline of foreign competition and the efficiency improves, but the gains through increases in output associated with sales in the markets of partner countries are not obtained.

Technological change. Economic integration may contribute to the spread of technological knowledge by putting in touch the domestic producers with new products and processes originating in the trading partners. The transmitted technological knowledge will be higher when an integration arrangement includes not only goods and services mobility but also factors mobility, especially (fix and human) capital mobility. Moreover, a greater competition derived from integration can lead to technical progress in the member countries by stimulating the research activities to develop new products or processes. Coe and Helpman, (1993); Baldwin, (1993) have proved that integration enhances a country's opportunities to improve its efficiency by participating in other countries' technological progress or in R&D investment. Furthermore, Badinger, (2001), by estimating the growth effects of economic integration in EU members, supported the previous studies, concluding that technological advances are an important channel by which growth effects of economic integration are materialized.

Investment. Investment is a necessary complement to trade, particularly in the case of service industries, which must provide their products at the source of consumption, and a variety of high-tech goods industries that require consumer education, special credit arrangements, and after-sales service (Gerber, 2000).

According to Baldwin, (1993), by allowing a more free interplay between market forces, the market liberalization involved in closer economic integration can improve the efficiency of productive factors, allowing for greater output from the same inputs. A side effect of improved efficiency is an improved investment climate in the integrating region.

[15] The pro-competitive effect will be more favorable with differentiated goods industries producing under economies of scale. Since the differentiated nature of the products boosts the market power and the economies of scale tend to concentrate production, this process becomes sometimes a justification of national monopolies.

This in turn will result in a higher investment rate, thereby raising the initial output gains by providing the economy with more resources. The same sort of induced capital formation can also boost investment in human capital and knowledge capital. In the same line, Baldwin and Venables (1995) have claimed that an RIA will affect growth if it changes the return on investment in physical, human or knowledge capital and hence spurs accumulation.

Regional integration will usually affect factor prices, including the rate of return on capital, in member and non-member nations. So, the potential for investment creation and investment diversion have played an important role in the public debates on RIAs (Baldwin and Venables, 1995; Dee and Galli, 2003). Dee and Galli (2003) by analyzing "investment creation and diversion" suggested that in an increasingly integrated world economy, even minor trade concessions can have a significant impact on investment flows. If capital is perfectly mobile internationally, a pure "investment diversion" will be generated whereby capital flows to the RIA countries from the rest of the world.

The hypothesis of the investment-led growth in the frame of integration agreements has its roots in Balassa (1961). He underlined the role of economic integration in generating a more favorable condition for entrepreneurial activities (less uncertainty) by reducing the risk premium for investments and reducing capital costs which leads to more efficient financial markets. Then, such hypothesis can be observed in the work of Baldwin and Seghezza, (1998), who suggests that lowering the risk premium raises the stock market value of any given investment. Further, by discussing capital accumulation they stressed that trade-induced growth can be done through three types, one of which was investment - led growth. Badinger (2001) also shows that the ties between integration and growth run both over increases in efficiency as well as induced investments.

It is noteworthy that from the point of view of Gerber, (2000) developing countries are interested in ensuring that they receive private capital flows, while high-income economies seek to take advantage of new systems of global production. In general, investment agreements seek to provide foreign investors with national treatment, to create an investment form of Most Favored Nation (MFN) status, to remove performance requirements, and to eliminate restrictions on capital and profit remittances. From the

standpoint of host countries, the goals are to raise national investment levels, increase the rate of technology transfer as well as economic growth.[16]

Foreign Direct Investment (FDI). The globalization ongoing process is accompanied with regional integration in which Foreign Direct Investment (FDI), or investment by transnational corporations and multinational enterprises in order to control assets and manage production activities in integrating countries, represents a great essential business phenomenon (Mallanpally and Sauvant, 1999).

In the same line, the World Bank, (1997) claims that an important focus of the debate surrounding all RIAs is how such arrangements may affect inward and outward foreign direct investment flows in the integrating region. In this connection, (Blomstrom and Kokko, 1997) argued that enhancing FDI, induced by regional integration, can be a catalyst to efficiency gains and greater growth due to spillovers of technology transfer. In compared static effects based on a more efficient resource allocation in terms of short-run effects, this can imply long-run effects on growth and productivity.[17]

Foreign direct investment (FDI) has grown at a phenomenal rate since the early 1980s and the world market for "direct investment" has become more competitive. Developing countries are becoming increasingly attractive investment destinations, in part because they can offer investors a range of "created" assets (Mallanpally and Sauvant, 1999). Also, although developed countries remain the leading source of outward foreign direct investment (FDI), developing and transition economies have emerged as an important source of outward FDI since the 1990s (Al-Sadig, 2013) [18].

Since an important share of investment in developing countries is foreign direct investment (FDI), it is nowadays considered a major incentive of integration between countries, especially if integration takes place between developing countries, given the link with two important variables: exports and economic growth (Hosny, 2013).

[16] Circumstantial evidence suggests that RIAS can generate investment booms, as occurred for example after the creation of the European Economic Community (EEC), the Iberian enlargement of the European Community, the European Community 1992, the North American Free Trade Agreement (NAFTA), and Mercosur (World Bank, 1998).

[17] However, (Anastasia and Panagiotis, 2014) examining the relationship between integration and growth for three different country groups (European Union member-countries, European Monetary Union member-countries and countries in transition) do not find a robust causality relationship between FDI and economic growth.

[18] Between 1980 and 2011, their share of world outward FDI rose from 6.2 percent to 26.9 percent and peaked in 2010 at 31.8 percent (Al-Sadig, 2013).

Further, Peiris et al., (2015) by reviewing several works, conclude that these studies in developing countries provide evidence for significant technology transfer from FDI. Due to a limited investment in R&D and therefore a weak R&D base, as well as, infrastructure, production and manufacturing capacity in developing countries, most of the inward FDIs to these countries originate from the developed countries, generating a positive effect on the productivity of the developing countries.

Regional economic integration can provides an important incentive to FDI within the integrated region. In the context of economic integration theory, it is generally recognized that FDI is one of the principal dynamic channels managing to the long-run growth. So, one of the fundamental dynamic objectives of the RIAs is to increase FDI flows within the area. The argument that FDI not only provides direct capital investment but also means technology (know-how) transfer and diffusion, mainly due to the spillovers to local firms, is the hot topic of RIA debates (Egger and Pfaffermays, 2002; Uttama and Peridy, 2009). These channels could increase productivity in the countries, which in result leads to more investments and a faster growth.

Innovation. The dynamic effects are all connected with each other. The economic integration theory (in the context of the endogenous growth theory) considers that the key for a long-run growth is in the country's ability to implement research and development (R&D). In this respect, innovation is assumed to be the engine of growth stemming from higher levels of FDI and technological transfer. The innovation occurring through new technologies resulting of investments (FDI) leads to the relationship between trade liberalization and technological progress, especially in the process of economic integration.

According to the endogenous growth theory, profit-seeking investments in knowledge play a critical role in the long-run growth process (Romer, 1986; Grossman and Helpman, 1991; Aghion and Howitt, 1992). Innovation is an outgrowth of costly investments in industrial research. Obviously, such investments reply to opportunities, which reflect competitive conditions in national and international product markets. Since firm's race in different countries brings out new products, the growth processes are linked with the international technological competition. This justifies that economic integration affects indeed the level of competition in a market, which in turn leads firms to innovate.

Trade liberalization and integration lead to technological competition which in result increases foreign economic competition. This relies on firms facing price

competition, inducing them to raise R&D effort, innovation and growth. From this point of view, Grossman and Helpman, (1994) also put attention to the important role of international trade and integration agreements in the growth process involving the transmission of innovations within integrated area and noted that these perspectives have led to casting industrial innovation as the engine of growth.

In summary, increased efficiency that leads to more output from the same amount of inputs in a first round (**static effects**) is one part of the economic integration effects. The second part occurs when dynamic principles lead to higher investment and an increase in the capital stock, which in turn increases output in a second round (**dynamic effects**).

Actually, though static and dynamic effects may seem diverse in nature, both are significantly connected through different links. Baldwin and Segneza (1998), in a work focused on trade-induced knowledge-led growth, emphasizing the impact of trade liberalization on the incentive to investment on product and process innovations, have found a number of static and dynamic growth links: Traded intermediate goods; Inter-sectoral expenditure shifts and Pro-competitive Effects.

Typically, the first link among the static and dynamic effects occurs due to the traded intermediate goods. The production of capital involves commerce intermediate goods and this creates a simple link between openness and investment-led growth. The increase of trade after the removing of trade barriers also affects intermediate goods, affecting the production of both forms of capital. When the manufacture of human knowledge or physical capital includes commerce intermediate inputs, the price of traded goods enters the marginal cost function. Trade barriers affect these prices, so the price of capital becomes a function of trade barriers.

Secondly, these effects are linked by inter-sectoral expenditure shifts. When traded sectors are more (physical) capital intensive compared to non-traded sectors, RIAs shifting demand to the capital-intensive traded sector boosts the derived demand for capital. In the short-run, this would increase capital accumulation and in the long-run would increase growth.

Finally, a connection emerges on the fact that reciprocal liberalization may produce a pro-competitive effect. The mechanism through which an RIA changes price cost mark-ups is often referred to as the pro-competitive effect of integration. Pro-competitive effects

may be substantial, leading to significant increases in firm scale, and may increase or decrease the incentive to innovate.

The possibility that an RIA will have pro-competitive effects on price cost mark-ups means that two additional welfare effects come into play: trade-volume and trade-cost effects as terms of trade effects when prices change. Pro-competitive effects of integration bring about an expansion of firms in RIA countries, thereby reducing average production costs. Certainly, a reduction in average costs is spread over all the firms' output, non-traded as well as traded, which means that the effect may be quantitatively important (Baldwin and Venables, 1995).

2.4.1. Effects of economic integration for developing countries

After discussing the main static and dynamic effects of economic integration (in the context of the "traditional" and the "new" regionalism), in this section we discuss the particular case of developing countries. Some authors refer to the linkages between developing and developed countries, which many RTAs introduced in the past two decades, as the twin characteristics of “new regionalism", (Burfisher et al, 2004). For developing countries, in particular for the smaller ones, economic independence was not easily attainable and integration was seen as one way through which greater independence could be achieved (Mackay, 1984).

The literature of economic integration dealing with developing countries has generally recognized that for such type of countries neither the “traditional” nor the “new” economic integration theory is adequate. Nevertheless, the traditional theory seems more controversial than of the new integration theory.

According to Meier, (1960); Balassa, (1965); Abdel Jaber, (1971); Mackay, (1984), the orthodox theory of Viner-Meade-Lipsey with their traditional restrictive approach (centered on the static effects of resource allocation) is not appropriate to the case of developing countries. “Old” economic integration theory was certainly derived from neoclassical assumptions of full employment, perfect competition, constant returns of scale and perfect mobility of production factors; accordingly, the analysis is constrained only by the static effects of economic integration (Abdel Jaber, 1971). The emphasis should be put on dynamic effects (Mikesell, 1965; Sakamoto, 1969; Abdel Jaber, 1971; Rueda-Junquera,

2006). Meier, 1960 had argued that Viner's analysis was concentrated on a limited range of welfare effects in the frame of lesser-developed countries.

Furthermore, from Balassa's point of view Balassa, (1965), the content literature of economic integration theory was concentrated on the rational customs union relying exclusively upon industrialized countries. The environment and difficulties of these countries do not apply to economic development, rather than to a tariff issue and production/consumption shifts. Also Mackay, (1984) has claimed that assumptions of the basic theory do not conform to the economic preconditions and existing structure found in the third world, and the requirements for successful integration, as suggested by Viner (1950), are not usually fulfilled by developing countries.

Hence, soon after Viner's contribution, researchers come to argue with a special emphasis on the effects of integration to less developed countries and the motivation of these countries to participate in integration processes, in the frame of the new economic integration theory. Substantial researches have been done on this context like, among others, (Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al.,1969; Robson, 1980; Mackay, 1984; De Melo, 2011; Hosny, 2013; Marinov, 2014).

Although both aspects are related, following Hosny, (2013) and Marinov, (2014), who applied an appropriate systematization, this section attempts to review the **potential economic integration effects (the welfare impact)** in the case of developing countries, as well as the **determinants that influence the motivation to participate in integration processes** for these countries. In both cases, we will focus on the limitations of the traditional theory and the reasons why traditional approach is not sufficient or is not adequate.

2.4.2. The welfare impact of economic integration in developing countries

From the point of view of developing countries, the traditional analysis on the welfare effects of an economic integration agreement is not adequate in different aspects, not just when only production effects are considered (Viner's analysis) but also including consumption effects (Lipsey, 1957, 1960). Welfare effects of economic integration between less developed countries should also encompass the positive effects of employment, productivity and income effects, production specialization, competitiveness,

etc. (Abdel Jaber (1971); Mikesell, 1965). We present in what follows some of these aspects and its limitations in the traditional approach.

(1) Objective of economic development. To the developing countries, economic integration should be considered as a method to economic development or as development policies, not as tariff deals (Abdel Jaber, 1971; Balassa and Stoutjesdijk, 1975; and Mackay, 1984).

Several studies have stressed that an orthodox theory of economic integration, engaged in the static efficiency through the better resource allocation, may not often correspond with economic development objectives, engaged in the benefits of economic faster growth in the long-run as well as labour market aspects like unemployment and under-employment of production factors (Kahnert et al., 1969; Mackay, 1984).[19]

Moreover, Mackay, (1984) studying economic integration in developing countries in the case of "CARICOM", has claimed that the three basic objectives of integration agreements are: economic integration; functional cooperation in sectors such as transport, health, education, labour, information and services; and coordination of foreign policy. Therefore, he has concluded that economic integration also provides a framework for these forms of cooperation, as well as for increasing bargaining power in international negotiations and providing a suitable framework for the receiving and using of aid.

In a paper about regional integration in "SADC" (Southern African Development Community), (Shams, 2003) claims that economic integration in this region is understood mainly as an economic development process and less so as creating various or upper stages of FTAs. A look at the list of objectives of the SADC shows that not regional integration under the reducing tariffs and promoting intra-regional trade but economic and political development is the principle motivation behind the creation of common projects such as poverty alleviation, improving standard and quality of life through promoting healthcare and education, productive employment and utilization of resources. In addition, to the list of political objectives he referred to the security achievement as well as to the list including ecological, social and cultural objectives.

(2) Size of the countries. The potential economic integration gains in small and medium-sized member nations have been suggested by (Kreinin, 1964). When integration or overall

[19] In Europe, integration was concerned with the promotion of trade and more efficient resource allocation and utilization, whereas in the third world, objectives are based on the diversification of production structures and the general enhancement of development prospects (Mackay,1984).

trade occurs between a small country and a larger one, the small one will be more profitable due to the extension of its export via huge consumers demand. This is especially important when the small country is a less developed country and the large one is a developed country with higher purchasing power.

According to traditional integration theory, the bigger the size of the economies participating in the integration agreement, the greater potential gains of integration would be. Abdel Jaber, (1971) has emphasized that in the case of taking GNP for the economic size measurement, the integration gains for developing countries will be small.

But, as (Balassa, 1961) suggests, if the benefit of economic integration do not merely depend on the size of the countries, but also on the rate at which they increase, the integration gains for the less developed countries would be bigger than for developed countries, as the most developing countries have a higher growth rates. Taking population as a measurement of the integrating nation's size, developing countries would surely benefit from integration, as they are usually over populated (Hosny, 2013).

(3) Employment and productivity. The discussion of the employment and productivity effects can be found in Mackay, (1984), by debating features and problems in the third world he has claimed that the market structure of the less developed countries historically determined comparative advantage concentrates production and trade on a limited range of usually low technology goods. Moreover, unemployment and under-employment of factors of production remain a major problem.

Similarly, Hosny, (2013) has stressed that in most developing countries, there exists a situation of generally low productivity, plus mounting unemployment. So, a country can get gains even under trade diversion. If trade diversion cause labor shifts from low efficient to high-efficient sectors or activities it can boost the welfare growth. The welfare gain will be most obvious under unemployment (Sakamoto, 1969).

(4) Beneficial trade diversion. Trade diversion may be efficient in the case of developing countries (Demas, 1965; Linder 1966; Sakamoto, 1969). They underlined some basic principles about benefits of trade diversion: First, it will enlarge the size of the market by reducing costs due to economies of scale. Import substitution allows the integrated area spending more foreign exchange in imports of capital goods, contributing to the increase of investment and economic growth. From the consumption side, trade diversion by allowing

consumers to buy imports at lower prices, after the removal of tariffs, increases their savings.

Linder, (1966) and Sakamoto, (1969) refer this fact as "efficient trade diversion." The economic conditions of developing countries should not allow welfare reduction in the case of trade diversion because the production replacement will be from an efficient non-member developed country to a relatively efficient developing member country, creating benefits in terms of employment and income within the union.

However, Elkan, (1975) has disagreed with the benefits of trade diversion arguing that the loss in tariff revenues will be balanced by all these effects. This assumption may be of significant importance to less developed countries, especially to the smaller ones, as these countries fear a decline in tariff revenue since the tariff revenue is a fundamental income source of the overall government budget in most of these countries.

(5) Protection for industrial development. Although Viner's approach was concentrated on a limited range of welfare effects, he has argued a very important point that economic integration in some cases may be a step for free trade, but in others a step to protection. Cooper and Massell, (1965b), perhaps the first who analyze economic integration in developing countries, as well as Sakamoto, (1969), argue that for less developed countries protected trade regimes may be beneficial.

They consider that "a principle objective of economic integration among less developed countries is to foster industrial development and to guide such development along more economic lines."

This objective can be obtained via protection provided by economic integration, so (Sakamoto, 1969; and Lizano and Willmore, 1975) referred it to the equivalent of import substitution and export expansion as an important tool for development and industrialization policies. Economic integration therefore provides through market extension and protection important preconditions that can aid development, in particular the opportunities to exploit economies of scale.

The protection provided by economic integration may also allow for dynamic economies associated with new industry which has no inherent disadvantage but only a present inferiority of acquired skills and experience.

There is an expectation that over time the costs facing the industry will fall as the necessary skills and experience are acquired (Mackay, 1984).[20] Furthermore, Cooper and Masselll, (1965b), who are willing to accept a reduction in national income to achieve an increase in industrial production, have concluded that for evaluating the customs union effects on each member country not only the national income changes, but also the level and changes in size of industrial production must be taken into account.

The Cooper and Massell analysis is for integration between a North developed country and a South developing country. In the case of the establishment of a customs union between two less developed countries, trade diversion in industrial products will allow increasing welfare under the consumption terms resulting from decrease in prices by removing tariffs. Apart from such process, welfare will decrease under the production terms (here welfare viewed as the efficient use of resources). This occurs when production is shifted from an efficient non-member country (third developed country) to one of the inefficient developing member countries of the union. Hence, by joining such trade diversion together with a common external tariff that protects domestic industry, the development of the industrial sectors in both member countries can be achieved.

Eventually, Cooper and Massell, (1965b) concluded that this process would give a greater benefit in the case of industry complementary of these developing countries since the supply of each country matches the demand of the other, resulting in the expansion of their industrial production.

Finally, we should consider the work of Elkan, (1975) concerning the unequal distribution of the benefits for industrial production from integration among less developed

[20] The favorable protection effect by stimulating industrial development is discussed by the *"Training Ground Theory"*. This theory starts out from the hypothesis that the international competitiveness of developing countries can be gradually improved by relying on the regional market in the first phase of industrialization, when free trade among members, together with the usual high common external tariff on imports from the third countries, temporarily protect infant industries and provide at the same time sufficient large markets for future development (Inotai, 1991). This inward oriented approach or "import substituting industrialization" approach, involve policies designed to encourage development within the national framework (Mackay, 1984; Rueda-Junquera, 2006). Developing countries can enter into the world's market at a later stage, after reaching a certain degree of efficiency due to the advantages of economies of scale, technical development, and specialization on the regional level. From this angle, economic integration among this group of countries is considered as a transitional period towards open competition with the rest of the world (Inotai, 1991). However, in many cases facts do not support this theory: the fundamentally narrow regional markets did not allow industrial development or economy of scale advantages; there are wide differences in the structural pattern of extra and intra-regional exports; little or even no structural improvement took place in a result of the learning (training) process. Furthermore, there is no guarantee that developing countries will eventually commit themselves to opening or liberalizing trade with the rest of the world, so in the end, protection instead of being temporary may actually become permanent (Hosny, 2013) .

countries: the bigger gains of economic integration are focused only in one or few member countries. While referring to economically weaker and geographically remote participating countries this effect will be lower.

(6) International competitiveness. Following the discussion given above one can suggest that developing countries have based their arguments for getting benefit from economic integration, firstly, in the benefits of trade diversion and import-substituting industrialization. The second kind of arguments, viewed as long-run ones, are the "dynamic effects" by enlargement of the market within an integration framework, arguments like economies of scale, investment, technology transfer, etc.

These countries have taken a further step, and most of the less developed countries now follow another strategy consisting in trade liberalization and deregulation policies (Rueda-Junquera, 2006). They follow such policies in order to get regional market stabilization which helps in encouraging new investment opportunities and general adjustment programs under the international organizations frameworks. At this regard, developing countries are looking to economic integration as an instrument for a more competitive insertion into the global economy (Hosny, 2013).

In this sense, according to Mackay, (1984) integration can act as a framework for the development of common policies (political and economic) toward the rest of the world. As such, the total may be greater than the sum of the parts in bargaining power vis-a-vis other economic groupings and international organizations. This is relevant to the political and economic independence of the region in having greater control over the direction and type of development. For many third world countries this aspect is particularly important.

(7) Economies of scale. In general, developing countries are specialized in primary products, what is not a problem if the economic surplus from the primary sector is reallocated or reinvested efficiently in other sectors (Abdel Jaber, 1971). But, in general, that is not the case and developing countries have supported a diversification policy and import substitution to several degrees in order to speed up economic growth.

However, balance growth can be achieved by small developing countries by increasing the size of the market, benefiting from economies of scale and expanding their inter-industry transactions in a context of economic integration (Demas, 1965).

(8) Trade pattern with developed countries. Most of imports of developing countries from developed countries are capital goods (in the form of investment) (Mikesell, 1965).

This suggestion implies that the volume of imports of less integrating developed countries is likely to increase, as according to the dynamic approach integration between these countries requires higher investments. The inference of Mikesell, (1965) was significant, as he noted that the long-run target of integration between less developed countries should not be decreasing trade with the rest of the world but rather making changes in their trade structure.

Sakamoto, (1969), who supports the conclusion of Mikesell, takes into account the availability of foreign exchange as a determinant of imports in developing countries. If a result of integration between less developed countries take place with a trade diversion in consumer goods, this will release the larger foreign currency targeting at more imports of capital goods from third (developed) countries. Eventually, the volume of trade flows with the non-member countries may not change or may actually increase, but the most important thing is the changing of the trade structure.

2.4.3. Integration determinants in developing countries

There are several determinants that influence the motivation of participating in an integration processes. In the case of developing countries, these factors go further the static and dynamic effects determining net welfare effect. Below we review the limitations showed by the traditional economic integration theory in relation with factors which are important to developing countries.

(1) Macroeconomic policy coordination. Even if all trade conditions of a more developed countries could be fulfilled in less developed countries, the macroeconomic policies divergence and lack of coordination between them lead to limit of growth potential (Shams, 2003).[21]

Certainly, the issue of policy harmonization between participating countries has been discussed as far back in the studies of (Balassa, 1961; Kahnert et al, 1969; Hirschman, 1971; Andic and Dosser, 1971). For instance, according to Balassa, policy

[21] This paper, analyzing the MERCOSUR case, has claimed that the most serious obstacle to the development of this union is the lack of coordinated macroeconomic policies in the two most important member countries Brazil and Argentina, particularly in exchange rate policy. Uncoordinated changes in exchange rates can hamper trade integration in the region. Although Brazil and Argentina are profiting from their low transport costs and large market size, because of shortcoming coordination in macroeconomic policies, they are not getting full effects of economic integration. Consequently, (Shams, 2003) concludes that the success of MERCOSUR is, therefore, dependent on the coordination of macroeconomic policy and a unification of exchange rate policies.

differences between the member countries may influence trade flows and factor movements, thereby modifying the welfare effects of economic integration. Industrial policies, social policies, fiscal policies, monetary policies, and exchange rate policies are relevant in this context (Balassa, 1961).

Further, from the point of Hirschman, (1971), integrating countries should try to uniform their internal monetary and foreign exchange policies with the aim of trade agreements be durable. He suggested that such progress could be more important in promoting trade between the member countries than the customs preferences themselves. In addition, Andic et al., (1971) has got under consideration this issue in the context of developing countries, and claimed that two shortages in developing countries are the foreign exchange gap and the savings gap. De Melo et al., (1993) consider that, in addition to monetary and exchange policies, coordination should be extended to industrial, environmental, social and welfare policies.[22]

(2) Competitive Vs complementary countries. An interesting issue in the case of developing countries is the suggestion of Viner, (1950) and Lipsey, (1960) that competitive countries gain more benefits from economic integration than complementary countries. Makower and Morton, (1961), supporting Vinerian point, explain that gains will be larger the larger the cost differences of producing the same good in the integrating countries.

Since most of the developing countries specialize in export of primary products, one can refer to these countries as competitive ones according to Viner's argument, so this analysis is in favor of developing countries. Along with this true argument, there is another view that reduces the benefits of economic integration among less developed countries because the large export flows of less developed countries is attracted by developed countries, leading to decreasing the volume of intra-regional trade (El-Naggar, 1964). Nevertheless, Abdel Jaber, (1971), paying attention to the large category of primary products, has stressed that if these products are disaggregated the potential benefits can arise. Balassa (1965) mentioned that Vinerian argument concerning competitiveness and complementarity is not at all appropriate regarding to the less developed countries. Precisely, the objective of these countries is to achieve a significant degree of

[22] The issue of harmonizing domestic policies will be especially important if member countries are of different development levels. The steps to deeper integration are determined by rich, developed countries, while developing countries will have to adjust their standards to those of the developed countries (Panagariya, 1998).

complementarity between them and then get benefits from economic integration (Mikesell, 1965). Similarly, Marinov, (2014) claims that after obtaining higher complementarity developing countries can increase the volume of intra-regional trade between them and get integration gains.

Moreover, several works Langhammer and Hiemenz, (1990); Inotai, (1991); Shams, (2003), supporting the above discussion, have argued that less complementarity and similar economic structure would not be useful between developing countries. For instance, Langhammer and Hiemenz, (1990); Shams (2003) have considered that one of the obstacles to south-south integration was that it included countries with a low and similar level of development and similar resource endowment. In this case, there is neither much scope for inter-industry specialization nor the countries have the option of intra-industry specialization.

(3) Intra-regional trade and total regional trade. According to Mackay, (1984), in any form of economic integration it is likely that there will be changes in patterns of trade among the integration partners (intra-regional trade) and between the members and the rest of the world (extra-regional trade). In terms of trade pattern changes, (Lipsey, 1960) claims that a customs union will more likely produce welfare gains the higher is the share of trade with its partners and the lower the share of trade with the rest of the world. Since the proportion of trade between developing countries is small in comparison to trade between developed countries, gains from integration between developing countries would be small (Hosny, 2013; Marinov, 2014).

However, other studies Balassa, 1965; Abdel Jaber, (1971) consider that this conclusion should not always be acceptable. If some factors limiting trade between developing countries, like a low level of economic development, inadequate transport facilities, foreign exchange controls and other import restrictions, inadequate marketing and shortcoming of standardization, are eliminated, trade flows probably would increase among these countries in a context of integration.

Although in general is supported that the best indicator of a successful economic integration agreement is the increase of the share of intra-regional trade to total trade of the member countries, Inotai (1991) shows that it should not be the only one. In fact, the joint industrial development, adequate infrastructure, and growing level of technology are also important targets. What is more, the growth of total regional trade may actually be derived

from trade diversion from more efficient and competitive non-member countries. Consequently, it can be assumed as positive only when it is combined with improvements in competitiveness in world markets.

(4) Trade as a percentage of GDP. Lipsey (1960) argues that countries are most likely to benefit from economic integration if their volume of foreign trade as a percentage of their GDP is lower. This factor is quite relevant for developing countries since the trade openness of these low-income countries has always been lower than that for high-income countries, although this ratio has increased in the past few years (Hosny, 2013).

However, Hosny, (2013) has stressed that such observation does not apply to middle-income countries and least developed countries, both groups having higher trade openness level than that of the high-income group. Therefore, he has concluded that this criterion is not appropriate to developing countries, as sub-groups within these countries may have higher or lower ratios of trade to GDP compared with high-income groups.

(5) Initial tariff rates. The higher the initial tariff rates between countries entering a customs union, the larger are the expected gains of economic integration between them (Meade, 1955). Since the initial domestic tariffs in developing countries are in general high (trying to protect national production system or increase revenue), this factor is of substantial relevance for the developing countries.

(6) Transport costs. The transport costs, as a natural trade impediment, reduce the potential gains of trade integration between any countries. While many studies Linneman, (1966); Balassa, (1975) have proved that distance has negative effects in trade, Clark and Stanley, (1999) have asserted that distance affects negatively in particular intra-industry trade.

This point is especially relevant to the conditions of less developed countries participating into trade agreements for at least two reasons. The first is connected with the findings of Linder, (1966), as mentioned above, that countries with similar per capita incomes rely more on intra-industry trade. The second is that transport infrastructure and facilities in general in the less developed countries do not correspond with conditions of the developed countries, as they have significantly poor or absent infrastructure. Perhaps, even existing facilities were historically determined to promote the transport of export of primary products from the less developed to more developed countries.

Consequently, according to Balassa, (1965) transport costs between two neighboring less developed countries may actually be higher than those between a less developed country and a remote developed country. This will turn to a more important issue when dealing with the economic integration between less developed countries. Therefore, Abdel Jaber, (1971) properly has asserted that regarding to the preparation of integration agreements among less developed countries one should pay special attention to the challenge of existing transport facilities and infrastructure.

(7) Political factors. Not only the reviewed economic factors, but also a number of political factors determine the desirability and the success of an economic integration agreement; these factors are of general importance but with a special relevance in the case of developing countries (Allen, 1963; Inotai, 1991; Grossman and Helpman, 1994; World Bank, 2000). Between other political determinants, we can mention the following:

- The **increased bargaining power** of the members when they bargain together in international negotiations is an incentive to integration (Inotai, 1991; De Melo and Panagariya, 1993; Worl Bank, 2000).
- Politicians can decide enter into trade agreements **to gain the support of certain interest groups (lobbies)**. At this regard, producers are a group having more political weight (or power) than consumers. Then, in general, a PTA will be favored politically than free non-preferential trade. Moreover, since producers will have a higher chance of benefits, a PTA being trade- diverting will be favored politically than a PTA being trade-creating (Inotai, 1991; Grossman and Helpman, 1994; World Bank, 2000).
- Some integration agreements are promoted by a member country, which is necessary for the successful of the integration project (Rueda-Junquera, 2006), but with the ultimate goal of strengthening its **leadership position in the region** and to avoid the influence of third-country on member countries.
- Some regional integration agreements are created **to encourage intra-regional security**, behaving more as security organizations rather than economic organizations (Worl Bank, 2000; Shams, 2003).
- An economic integration agreement between neighbor countries can **reduce the illegal border migration** and its associated problems.

- **Strategic reaction**. Countries tend to form Preferential Trade Agreements (PTAs) in response to other countries forming PTAs (De Melo and Panagariya, 1993).

2.5. Conclusions

This chapter reviewed the theoretical and empirical literature on economic integration, with special emphasis on the effects of integration agreements for developing countries. We began by defining the concept and forms of economic integration, that is, what economic integration means and how the integration process takes place. Then, we focused on the reasons why countries enter into an integration agreement, that is, the potential effects of economic integration on welfare. Two main approaches explain the gains from integration: the "Traditional Economic Integration Theory" and the "New Economic Integration Theory".

The Traditional Theory or "Old Regionalism", based on the analysis of Viner (1950), explains the so called "static effects" in terms of *trade creation* and *trade diversion*. After several developments of the Vinerian approach in the 50's and 60's (Meade, 1955; Lipsey, 1957, 1961; Linder, 1961), studies by Balassa (1962), Hansson (1962) and Cooper and Massell (1965) introduced a different approach, outlining the potential welfare effects of economic integration on "dynamic effects". These effects, which contribute to create a more favorable environment for economic activity, which have an impact on the members' growth in the long run, are, among others: economies of scale, technological progress, productivity growth, the impact on market structure and competition, reduced risk and uncertainty, increasing investment and foreign direct investment, lower costs of capital and incentives to innovation.

In the case of developing countries, the rationale behind economic integration cannot be defined in terms of static effects, but also the dynamic effects analysis has to be carried out carefully. In the light of the integration literature, we have seen that the orthodox theory of Viner-Meade -Lipsey with their traditional restrictive approach is not appropriate to the case of developing countries (Meier, 1960; Balassa, 1965; Abdel Jaber, 1971; Mackay, 1984). The static effects are not usually a feature of successful integration in developing countries, as it may not always correspond with its economic development objectives. The assumptions of the basic theory do not conform to the economic

preconditions and existing structure found in these countries and the requirements for successful integration, as suggested by Viner (1950), are not usually fulfilled by developing countries (Mackay, 1984).

So, in the context of the New Regionalisms, special accent should be put on potential dynamic effects in analyzing the effects of economic integration of developing countries and the motivation of these countries to participate in integration processes (Mikesell, 1965; Sakamoto, 1969; Abdel Jaber, 1971; Rueda-Junquera, 2006). The review of the literature on the potential economic integration effects (the welfare impact) in the case of developing countries, as well as the determinants that influence the motivation to participate in integration processes for these countries show that in both cases the traditional theory presents limitations and the traditional approach is not sufficient or is not adequate. Welfare effects of economic integration between less developed countries should also encompass the positive effects of employment, productivity and income effects, production specialization, competitiveness, etc. (Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al,1969; Robson, 1980; Mackay, 1984; De Melo, 2011; Hosny, 2013; Marinov, 2014). In more general terms, economic integration in the case of developing countries should be treated as an economic development policy, not as a tariff issue. Moreover, in addition to economic factors, there are a number of political determinants explaining the gains from integration and the desirability to enter into integration processes which are especially important in the case of developing countries.

Further, due to the principal motivations of the integration groups in the less developed countries, the reviewed literature revealed that economic integration in these countries should be behind the creation of other common projects such as poverty alleviation, improving standard and quality of life through promoting healthcare and education, productive employment, information, services and coordination of foreign policy.

Globalization and regional integration processes are essential characteristics of today's world economy, which have been significantly developed after the 1950s. Accordingly, on the threshold of the XXI century a process known as "new regionalism" has emerged. Since the second half of the XX century, in a context of rapid economic growth, an intensive development of international trade in goods and services took place; the result was a number of commercial agreements between countries.

Following the Second World War, a few number of integration agreements were enforced, mainly in the developed regions of the world, but in recent years regional integration reached nearly all countries in all continents. Nowadays, most countries in the world, especially developing countries, take part in one or more Regional Integration Agreements (RIAs).[23]

Such generalization of the world experience shows that the dynamics and scale of foreign economic relations of national economies gravitate around neighboring countries. Such an orientation of the integration process is called regionalization. Then, it seems that geographical proximity adds weighty arguments in favor of regional trade and economic integration. However, the degree and forms of the union can vary greatly depending on the level of development of countries, their geographical location, historical traditions and complementarities of production structures. One of the important aspects of the present wave of economic integration is its shifting paradigm. The underlying motives for economic integration in the 1950s and 1960s were very different from those today. Current initiatives involving developing countries are part of a strategy to liberalize and open their economies to implement export and foreign investment-led policies rather than to promote import substitution (Bhalla and Bhalla, 1997).

Given current developments of economic integration agreements, it has been more and more important to understand not only the rationale behind these arrangements but also their effects, particularly the impact on member states. The relevance of the economic integration has become a controversial topic for academics as well as for politicians. By reviewing the literature on economic integration, the aim of the chapter is to provide insights on what economic integration means, how the economic integration process takes place and, what it is more important, why countries engage in integration agreements, that is, the potential welfare effects of economic integration; in particular, in the case of developing countries.

In very broad terms, we can consider that economic integration emerges from eliminating barriers between groups of countries. During this process, countries remove a number of elements (or barriers) which made them differentiated and permitted them to protect their respective production systems. In doing that, these countries give each other

[23] In June 2014, the WTO declared 585 RTA notifications, of which 379 were in force; 412 were made under Article XXIV of the GATT 1994; 39 were pure Regional Trade Agreements (RTAs); and 134 under Article V of the GATT, (WTO, 2014).

special benefits which are not extended to third countries. Depending on these barriers which would be deleted, economic integration can take different forms or degrees; usually, following Balassa, (1961), five degrees are considered. Furthermore, together with that negative way to integration (by removing barriers), it is also necessary a positive way to the integration process in terms of common institutions and policies, both of them being complementary, (Tinbergen, 1954).

Since the first step to economic integration and the most common forms of integration are the formation of a Free Trade Area or a Custom Union by reducing or removing barriers to trade flows, the expected gains of integration are firstly the gains from trade. However, economic integration does not take place at global level (multilateral liberalization of trade in the WTO context) but just including some countries (the members of the preferential agreement) in a discriminatory preferential process. So, the potential effects of economic integration cannot be fully explained by the international trade theory.

The first work analyzing economic integration effects was (Viner, 1950), concluding that integration has two possible effects on trade flows, with different effects on welfare: *trade creation* (trade shifts from a high-cost supplier member state to a low-cost supplier member state within the union; having a positive welfare effects) and *trade diversion* (imports are shifted from a low-cost supplier of a third country to a high-cost supplier member country into the union; implying negative welfare effects) (Balassa, 1975).

Viner's static analysis of the effects of a Custom Union constitutes the T*raditional Economic Integration Theory* (or *Old Regionalism*). His conclusion that the net effect of customs union formation on welfare is ambiguous caused a large number of further developments during 50's and 60's by, among others, (Kreps, 1950; Meade, 1955; Lipsey, 1957; Balassa, 1961-1975; Johnson, 1965; Cooper and Massell, 1965).

As early as in the 60's, the conclusion was that the static analysis in terms of trade creation and trade diversion is insufficient to capture welfare effects of economic integration and the Dynamic Effects analysis is introduced by the so called *"New Economic Integration Theory"* in the context of the *"New Regionalism Approach"* (Balassa, 1961; Hansson, 1962; Cooper and Massell, 1965a).

These dynamic effects influence the accumulation rate, transforming the productive structure to a more competitive and specialized one, and then raising the country's rate of

economic growth over the medium term (Balassa, 1961, 1975; Abdel Jaber (1971); Baldwin, (1993); Schiff and Winters, 1998; Rueda-Junquera, 2006). The main dynamic effects are derived from economies of scale, technological progress and productivity growth, competition, reduced risk and uncertainty, a more favorable environment for economic activity, investment (and foreign direct investment) and innovation (Badinger, 2001).

When members of the integrated area are developing countries, although the new theory of economic integration is more appropriate than the traditional theory, the consideration of dynamic effects, as taken by the analysis of the integration of developed countries, do not explain adequately the welfare effects for developing countries.

The orthodox theory of Viner-Meade-Lipsey, centered on the static effects of resource allocation, is not appropriate to the case of developing countries (Meier, 1960; Balassa, 1965; Abdel Jaber, 1971; Mackay, 1984). So, the emphasis should be put on dynamic effects (Mikesell, 1965; Sakamoto, 1969; Abdel Jaber, 1971; Rueda-Junquera, 2006). The literature of economic integration theory was focused on integration of almost exclusively industrialized countries (Balassa, 1965). The assumptions of the basic theory do not conform to the economic preconditions and existing structure found in the developing countries, and the requirements for successful integration, as suggested by Traditional and New theories, are not usually fulfilled by developing countries (Mackay, 1984). The environment and difficulties of developed countries do not apply to economic development, rather than to a tariff issue and production/consumption shifts.

So, soon after Viner's contribution, in the framework of the new economic integration theory, a number of substantial researches have been done on the effects of economic integration agreements to less developed countries like, among others, (Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al,1969; Robson, 1980; Mackay, 1984; Marinov, 2014; De Melo, 2011; Hosny, 2013). These works are focused on the limitations of the traditional theory and the reasons why traditional approach is not sufficient or is not adequate in explaining potential economic integration effects (the welfare impact) in the case of developing countries, as well as the determinants that influence the motivation to participate in integration processes for these countries (Hosny, 2013 and Marinov, 2014).

In addition to production and consumption effects, welfare effects of economic integration between less developed countries should also encompass the positive effects of employment, productivity and income effects, production specialization, competitiveness, etc. (Abdel Jaber, 1971; Mikesell, 1965). Regarding the determinants that influence the motivation to participate in integration processes, in the case of developing countries, these factors also go beyond the static and dynamic effects determining net welfare effect. Moreover, in general terms but especially in developing countries, not only economic factors but also a number of political factors determine the desirability and the success of an economic integration agreement (Allen, 1963; Inotai, 1991; Grossman and Helpman, 1994; World Bank, 2000).

After this introduction, the chapter is divided into two parts and is organized as follows. In the first part, in section 1 we discuss the concept of economic integration and in section 2 we analyze the different forms or degrees that an integration process can take. In the second part of the chapter, devoted to the analysis of the potential effects of economic integration, section 1 discusses the Traditional Economic Integration Theories; section 2 discusses the New Economic Integration Theories and section 3 focuses on the effects of the integration process in the particular case of the developing countries. Finally, we present the main conclusion.

Chapter 2.

The Integration Process of Tajikistan

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Chapter 2

The Integration Process of Tajikistan

1.1. Introduction

Regional integration initiatives in Tajikistan do not have a long history, although it seems quite complex. The integration of Tajikistan in the global economy began with the establishment of the Commonwealth of Independent States (CIS) in 1991, continuing with agreements with some of the Post-Soviet Republics, like the Central Asian Cooperation Organization (CACO), and with countries outside of the post-Soviet space like China (in the Shanghai Cooperation Organization, SCO), Iran, Turkey and Afghanistan (Economic Cooperation Organization, ECO), as well as with the global market organizations and institutions like the UN, IMF or WTO. Since 2000, Tajikistan also takes part of the Eurasian economic Community (EurAsEC), the most successful integration agreement in the region.

As before independence Tajikistan was a member of the Former Soviet Union, in a very wide sense we can consider that its integration process with other ex-Soviet republics has a certain re-integrating character. Briefly, the Soviet empire had burst like a soap bubble, leaving only memories and chaos. While some countries have re-established themselves more easily, others like Tajikistan have re-established themselves after many years enduring difficulties. So, the history of Tajikistan has been printed by the decay of the USSR and the inevitable economic collapse in early 1991. Since the early years of the separation from the Soviet Union, Tajikistan has understood that the logic of the sustainable economic development was behind the regional integration efforts. Thus, in an attempt to achieve successful integration, the Tajik government chose an open policy and it starts being involved in several integration projects (MEDT, 2005). However, the relationship between country's objective and the options or integration direction was complex, as apparently Tajikistan wanted to be everywhere.

In trying to understand the rationality of the integration decisions of Tajikistan in terms of the potential integration effects, the first step is to know the integration process followed by the country. So, the main objective of this chapter is to provide a general

description and an analysis of the integration ways followed after independence and the most relevant integration agreements signed by Tajikistan.

We can consider three different options followed by Tajikistan in its integration strategy. The first option is specifically devoted to the post-Soviet initiative, whose engine is Russia. This also in its turn combined two strategies: agreements including the whole post-Soviet space (like the Commonwealth of Independent States, CIS, and the Eurasian Economic Community, EurAsEC) and the Central Asian regional agreements (like the Central Asian Economic Community, CAEC and the Central Asian Cooperation Organization, CACO). In the framework of the first option, that is within the ex-Soviet orbit, immediately after the collapse of USSR in 1991, the heads of state of Russia, Belarus, and Ukraine have signed the Agreement of Commonwealth of Independent States (CIS) and almost all the allies join this integration project. However, some of them (three Baltic States) join the European Union. The Minsk agreement (CIS) was the starting point of the regional integration actions in the post-Soviet Union area. Unfortunately, this prominent integration project turned ineffective and most of its goals have remained on paper (Freinkman et al., 2004; Pomfret, 2004; TAI and Lee, 2009; Libman, 2012; Dragneva and Wolczuk, 2013; Cooper, 2013; Embayev, 2014).

The CIS organization has been an "fundamental aspect" for any other integration agreements of the former Soviet Union (Putin, 2011; Laruelle, and Peyrouse, 2013). Thereafter, the attempts to develop the post-Soviet integration process involves a number of countries not all of them. The Central Asian regional integration, as one of the small format, has derived also from this CIS alliance. The literature on Central Asia regional integration shows that the main initiator for establishing integration project in this region was the President of Kazakhstan (see: Pomfret, 2004; Laruelle and Peyrouse, 2013; Kassenova, 2013).

Along with other Central Asian countries, the interest of Tajikistan in integration projects in this region remains uncertain. Because, in spite of several challenges such as the nationhood building, transition period and civil-war conflict, Tajikistan has shown especial interest in participation, but the result was a disagreement between most of the region countries (Ushakova, 2003; Kembayev, 2009; Kuzmina, 2012; Laruelle and Peyrouse, 2013). The lack of success in Central Asia integration was accompanied by some main reasons: first, these Republics have greatly feared the loss of sovereignty once more

(Laruelle and Peyrouse, 2013; Cooper, 2013). Second, Central Asia countries never had a common interest as well as the experience for integration (Kuzmina, 2012) or maybe these countries have become accustomed to Russia being always a "Big Brother" for them (Laruelle and Peyrouse, 2013).

After a decade of ineffective economic integration within CIS, the Eurasian countries under the influence of Russia and in some extent Kazakhstan decided to reinforce their association at least among those CIS countries that were willing to create an effective integration through small format project as EurAsEC. This integration project was created with the idea of "multi-speed" integration, as they did not want to repeat the CIS situation that was marked by severe economic and political difficulties. Indeed, unlike previous initiatives, some of the EurAsEC members under the leadership of Russia moved to a higher level of integration like Custom Union and the Common Economic Space (CES). The three member states with a strong desire for the multispeed integration could not stop in the first or second stages of integration. Consequently, full operation of the "Economic Union" begun in January 2015.

Although many works agree that today the Eurasian Economic Union (EurAsEC) led by Russia is the most successful and advanced union among all integration projects appeared in the post-Soviet area (Pomfret, 2004; Dragneva and Wolczuk, 2012; Kuzmina, 2012; Libman and Vinokurov, 2010; Cooper, 2013; Kembayev, 2014; Galiakberov and Abdullin, 2014; Yesdauletova, 2014), several studies affirm that the EurAsEC "weighted voting principle" as Russia's greatest weight in any association in the post- Soviet space is a problem, that is, the most worrying in this integration project is the Russian domination (Golovnin, 2008). Similarly, Cooper (2013) has claimed that a Russian leadership from a position of strength will have a negative impact on prospects for successful integration. As the dominant economy, there is a danger that any negative developments in Russia will have spillover effects in the smaller economies of the region.

Tajikistan's integration process was also seen at the multilateral level. Bearing in mind the importance of the integration to the global market as an engine of growth, the integration to the world economy or international financial institutions have been the second option for the foreign policy of Tajikistan.

Thus, within the Tajik open economy approach, accession to the World Trade Organization (WTO) would be a natural institutional goal. However, after independence in

1991, Tajikistan together with other post-Soviet countries were suspicious regarding the international commitments of WTO, which restrict their home policy rules. Tajikistan was pleased of entering the United Nations (UN) as a signal of nationhood, to join the International Monetary Fund (IMF) and the World Bank, and other regional development banks as potential sources of capital, but accession to WTO did not take place until 2013.

The third integration option of Tajikistan was an agreement with outsiders of the post-Soviet Orbit, mainly China and the Southern neighbors. As the agent which changed dramatically the geopolitical and economic position in Central Asia, China has quickly become a key player in the regional scene with the prominent Shanghai Cooperation Organization (SCO). Today the Central Asian region is acknowledged as the driving force ensuring the "peaceful rise of China" (Goldstein, 2005).

Finally, since Islam is the most widespread religion in Tajikistan and given the geostrategic position of the country, Tajikistan is seeking to strengthen its status in the Islamic world after the collapse of the Soviet Union. The country joined into a number of key institutions whose membership is based on the full or partial identification with Islam, like the Organization of Islamic Cooperation (OIC) and Economic Cooperation Organization (ECO).

In summary, Tajikistan has developed different integration options in parallel, being actively involved not only within the post-Soviet agreements or with a number of international organizations and financial institutions but also with other neighbors and outsider countries like China as well as with the Islamic World.

After this introduction, the chapter is organized as follows. Before turning to the integration issue, section two focuses on the antecedents and the disintegration period. Section three provides a survey of economic integration agreements involving Tajikistan, considering the three different integration options followed by this country in three subsections: the first subsection focuses on the integration within the “Ex-Soviet orbit"; the second subsection focuses on the global market initiatives; and the third subsection presents the integration agreements between Tajikistan and outsider “Ex-Soviet” orbit countries. Finally, in section four, we present some conclusions.

1.2. Antecedents

The Tajik Soviet Socialist Republic (Tajik SSR), as it was the official name of Tajikistan in the period from 1929 to 1991 as part of the Soviet Union, was an agro-industrial economy with no more developed industry and diversified agriculture which remain unchanged. In the structure of Tajik Soviet economy, the leading place was taken by agriculture (57%), followed by industry (31.5%) and services (11, 5%). According to Amir and Berry (2012), Tajikistan had the lowest income among all the republics of the Soviet Union, as a very remote region landlocked and with a mostly mountainous landscape. Although some heavy industry was moved to the region during the Second World War, Moscow mainly dedicated the Tajik SSR to growing cotton. For this, people were relocated and a vast irrigation network was set up to increase harvest and output. In the 1980s the Tajik SSR was one of the highest-yielding of cotton in the world, which was characterized also by its top quality (long staple). Based on this marked comparative advantage within the USSR, Tajikistan became so specialized in cotton that it developed nothing else, food included.

After the collapse of the Soviet empire, all Soviet Republics have faced many challenges with the shift from a centrally planned economy to a market economy, especially in the context of disconnection of ties among economic entities. Nevertheless, the consequences of the USSR's collapse have impacted on each member country in a varying degree. Some countries have re-established themselves more easily, while others like Tajikistan tried to re-establishing for many years with huge grave challenges such as alarming poverty, destruction and the terrible civil war.

In this sense, the history of Tajikistan has been imprinted by the decay of the USSR and the inevitable economic collapse in early 1991. Certainly, this dissolution had a number of serious negative impacts by falling output, the rapid rise of prices with a hyper-inflation rate over 2000%, the sharply collapse of demand and supply chains between USSR countries that eventually led to the completely disconnection of economic entities. Most of the infrastructure that survived from the Soviet collapse was devastated during the civil war. While neighboring republics were on the way of establishing transition period, Tajikistan’s economy was experiencing drawbacks with the effects of disintegration from one side and a civil war from another side.

1.2.1. USSR divergence as a leading aspect to disintegration

A high degree of convergence within integrated areas indicates the predominance of effective integration trends. By contrast, divergence is interpreted as a tendency towards disintegration or ineffective integration. Therefore, this indicator gives essential importance to Tajikistan in the context of being in high divergence in compare to the EurAsEC members or the other post-Soviet countries.[24]

Tajikistan has inherited this event from the Soviet era. Although in the Soviet period Tajikistan successfully bloomed, in terms of convergence, it was in dramatic divergence with the other USSR Republics. By analyzing convergence issues in the Soviet period, Didenko (2014) has found that spatial inequality diminished during the Soviet era but only modestly and not in all dimensions. However, by the 1980s the differences between these Republics have slowly increased considering a number of important parameters like (per capita GDP, physical capital, education index, etc.) which contributed to its disintegration. The divergence trend that emerged in the 1980s was evidently reinforced after the USSR dissolution. In other words, the collapse of the USSR characterized drastically by inequality between its former republics after 1990s promoted the process of disintegration in both the economic and the political sphere. Only in 2000 the disintegration process became stable, after the signing of numerous agreements within these countries (Didenko, 2014).[25]

1.2.2. From Disintegration to New Integration Projects

The Soviet Union disintegration in 1991 led to the result that in Central Asia region five newly independent states have been formed, the smallest one is the Republic of Tajikistan. Soon after the dissolution of the Soviet Union, the former USSR republics realized that they needed each other's assistance in the context of building their sovereignty, reform and economic development. Ever since, the former Soviet Republics

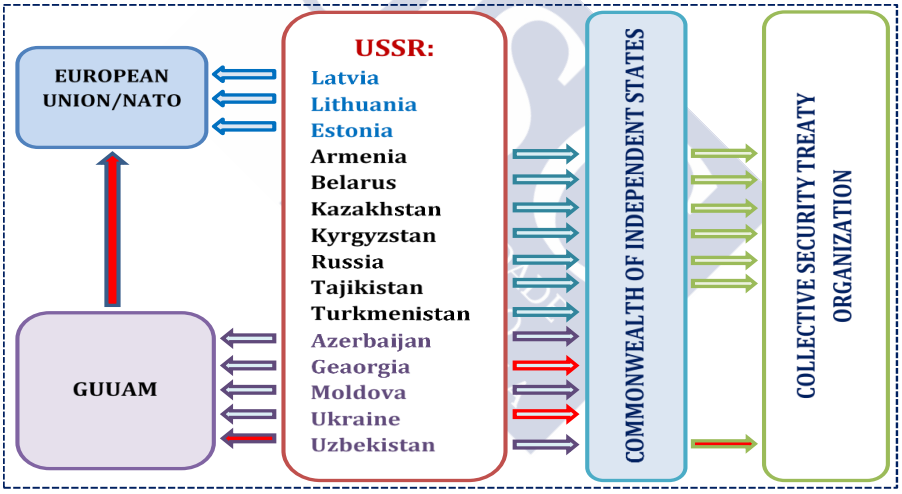
[24] In this sense, Golovnin (2008) has claimed that one of the key obstacles to the integration of EurAsEC Community is the differences in their member economic strategies and national models of economic development. There are significant differences in social and economic indicators between these countries, in particular in income which is in Tajikistan 10 times lower than in Russia (Sherbakova, 2010).

[25] This work also finds that the data for the post-Soviet period show that the divergence within the Eurasian Economic Community is much higher than among the CIS or post-Soviet countries. Hence, economically EurAsEC is a more heterogeneous association than the CIS or the USSR as a whole.

started signing integration agreements in order to build some union like the Soviet Union but in a "new style".[26] When the new independent states began searching for ways of interaction, after the breakdown of the Soviet Union, they took (and continue taking) the "European Union model" as a reference point, as opposed to the Soviet model. Despite the many problems, this is the only successful integration model that is used as an example not only in Eurasia but in Latin America and other parts of the world (Valovaya, 2012).

The disintegration process that took place after the collapse of the Soviet Union in the early of 1991 quickly gives place to various regional integration organizations with a military, political and economic nature. The first of them was the CIS (in 1991) and almost all the allies entered in this integration project. However, some of them (three Baltic States) join the European Union, which was the most important integration project in the time of the Soviet Union breakdown (Figure 2.1).[27]

Figure 2.1: The regional architecture of the post-Soviet States after the USSR collapse



Source: own elaboration

[26] Dragneva and Wolczuk (2013) has claimed that between all ineffective post-Soviet integration projects only the Eurasian integration project can be referred to the 'new style' project – one that appears to rely on a modern, rule-based legal and institutional framework in delivering economic benefits.

[27] "On December 8, 1991, a decision to dissolve the Soviet Union was taken in Belovezhskaya Pushcha. And on the next day in Maastricht, leaders of the European community decided to create the European Union (EU). The coincidence in the timing of these two events allows me to reword the famous proclamation of the French royal ritual: The Union is dead, long live the Union!" (Valovaya, 2012).

Moreover, the Collective Security Treaty Organization (CSTO) was signed on May 15, 1992 for a period of five year, with the possibility of further prolongation. The Republics of Armenia, Belarus, Kazakhstan, Kyrgyzstan, Uzbekistan, Russia and Tajikistan became parties of the CSTO. Later, Azerbaijan and Georgia joined the group also, but when Moldova, Ukraine and Turkmenistan refused to enter, they also left the Treaty.[28] However, the attempt to collect all CIS countries into one collective security block failed since Georgia, Ukraine, Uzbekistan, Azerbaijan, and Moldova seeking a more European orientation established another organization named by GUUAM in October 1997.

1.3. Integration agreements involving Tajikistan

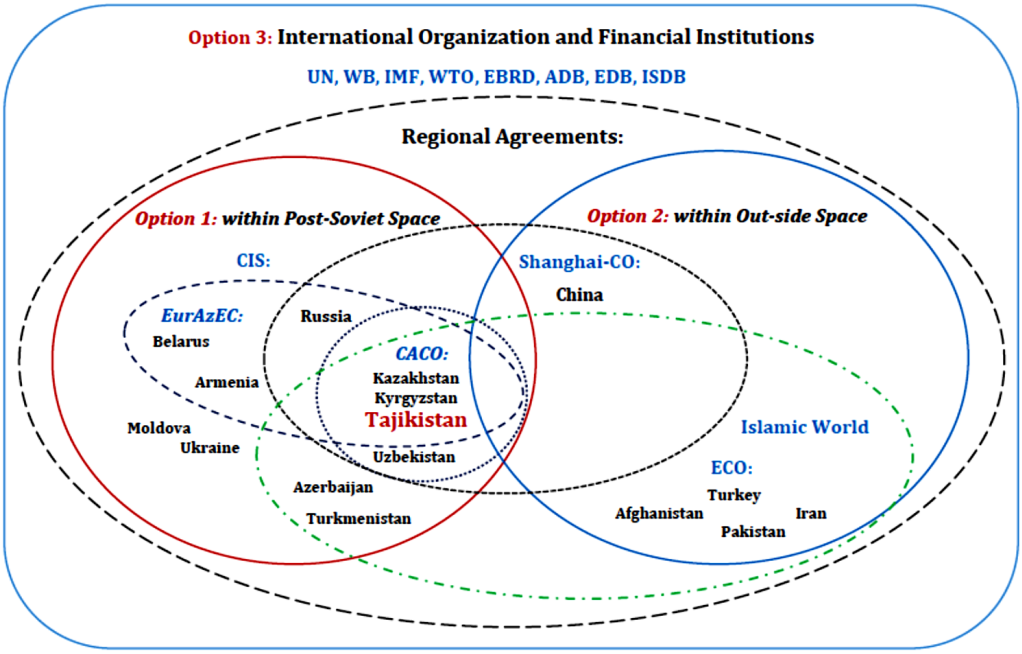
As was seen in chapter one, economic development is behind the regional integration efforts. For less developed countries like Tajikistan, economic integration is seen as the main engine of development not just, because tariff issues but also because these projects ensure poverty alleviation, education and health challenges, infrastructure development as well as the promotion of peace and security within and between the regions.

In today's world everything is interconnected and the current crisis put that into surface, increasing the interest in the dynamics of integration. Emerged in one part of the globe, it had a negative impact on both hemispheres. In order to avoid such negative consequences the best solution for Tajikistan seemed to strengthen cooperation in the framework of the integration agreements. Thus, the Tajik government, in an attempt to achieve successful economic integration, implemented an open policy (MEDT, 2005) and began to be involved in several integration projects. However, the relationship between

[28] According to the Article 3 of the Charter, objectives of the Collective Security Treaty Organization are to strengthen peace, international and regional security and stability, the protection of independence, territorial integrity and sovereignty of the Member States. The essence of the Treaty, its principals and forms of cooperation, as well as declared positions predetermined a real possibility for the Treaty to become an integral part of common and comprehensive system of collective security for Europe and Asia. Moreover, there is a serious effort to develop relationships with other international organizations acting in the sphere of security, such as the Counter-Terrorism Committee of the UN Security Council, the OSCE, the EurAsEC, the SCO, the CIS and the IMO (See: http://www.odkb-csto.org/structure/).

country objectives and the options or integration ways was complex, since Tajikistan wanted to develop different integration strategies at the same time (Figure 2.2).

Figure 2.2: Integration options followed by Tajikistan



Source: own elaboration

From the beginning, the integration initiatives in Tajikistan have a different aspect. The first option followed by Tajikistan is specifically devoted to the post-Soviet initiatives, whose engine is Russia. This also in its turn combined two strategies: one including the whole post-Soviet space and other focuses on the Central Asian countries.

Tajikistan followed other two ways in its integration strategy: one option consists in integration projects with the Southern neighbors as well as the countries outside the post-Soviet space, whose main agent is on the one hand the Islamic world and on the other hand it is China. The other considered option involves the agreements with international organizations as well as economic and financial institutions like United Nations, IMF or EU. As a result, organizations and agreements differ in their status and areas of activity. Hence, in pursuing economic integration projects, Tajikistan together with other Central Asian countries has faced to the choice between four options (Pomfret, 2004; Tai and Lee, 2009; Kassenova, 2013).

1.3.1. Agreements within the "Ex-Soviet Orbit"

The agreements within the post- Soviet space were the first option for integration projects not only for Tajikistan but almost for all Former Soviet Republics. This process is usually referred to as "re-integration" and is clearly led by Russia, perhaps because *"the Russian Federation has never abandoned her aims about the reintegration of post-Soviet states"* (Yesevi, 2014, p.1987).

1.3.2. The Commonwealth of Independent States (CIS)

Immediately after the collapse of USSR in the early of 1990, at the first onset, the heads of state of Russia, Belarus, and Ukraine signed the Agreement of Commonwealth of Independent States (CIS)[29]. The CIS was formed based on the "Bialowieza Agreement" (December 8, 1991) and two weeks later the Alma-Ata Declaration (December 21, 1991) with the aiming to maintain integrating relations in the field of economic, political and security between most of the former Soviet Republics[30].

All of the current EurAsEC members signed the Alma-Ata Declaration and joined the Commonwealth in an early step. From Central Asia, only Turkmenistan had never ratified the charter CIS but considered itself a member of the Commonwealth until 2005. After which UN has perceived its status as the "permanent neutrality," it granted observer status as an "associate member."

[29] See: http://www.cisstat.com/eng/cis.htm

[30] The three Baltic States (Estonia, Latvia and Lithuania) and Georgia are not members of the CIS agreement.

Map 2.1: The map of Commonwealth of Independent States (CIS), 1991

*Source: Central Asia Research Group (*http://www.asiacentral.es/grupoub/mapas.php*)*

In short, the Minsk Agreement (CIS) came to the conclusion that "the USSR has ceased to exist as a subject of international law and a geopolitical reality" and recognized the sovereignty, equality, and territorial integrity of each Republic. [31] The Minsk agreement (CIS) was as the starting point of the regional integration actions in the post-Soviet Union area, especially in the Eurasian scope.

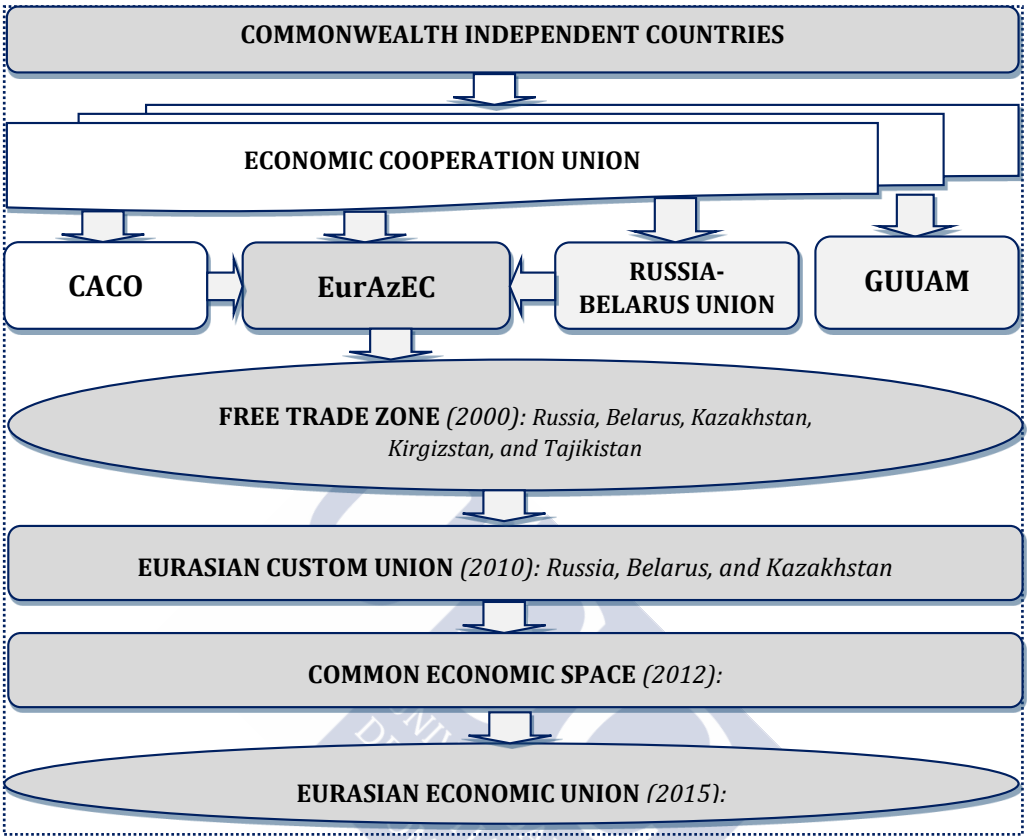
Several studies Freinkman et al., (2004); Tai and Lee, (2009); Pomfret, (2004); Dragneva and Wolczuk, (2013); Cooper, (2013(; Kembayev, (2014) widely believe that the CIS soon would not be taken seriously neither by the majority of its members nor by other countries, since the CIS never had a clear purpose and those who have they had never reached it. Tai and Lee, (2009) argued that in reality the CIS agreements incorporated little in the way of effective sanctions and enforcement power. These agreements expressed intentions, but did little to create working mechanisms. What is more, Pomfret, (2004) has claimed that the CIS agreements revealed zero practical impact. Dragneva and Wolczuk, (2013) have referred to this project as weak and ineffective institutional framework that is characterized by limited economic results.

[31] Agreement Establishing the Commonwealth of Independent States, Dec. 8 1991, 31 I.L.M. 142(1992).

In 1993 the CIS countries signed the Agreement on the Economic Union (EU), providing for the gradual establishment of a free trade area, a union, a common market and a monetary union. All countries of the Commonwealth became full members while Ukraine[32] has obtained the status of associate member. However, this project also turned up unviable by the fact that even the decision to create a free trade zone has not been ratified by half of the members, including Russia, (Kembayev, 2014). Furthermore, in December 1994, Russia, Belarus and Kazakhstan signed the treaty of a customs union signed in 1996 by Kyrgyzstan and in 1999 by Tajikistan making it a Union of Five. In the first place, this refers to a hastily developed integration project, whose principal function was ensuring a civilized character of the post-Soviet "divorce". In this sense, one can agree with the expression of the Russian President V.V. Putin (2007), when he said: "*The CIS really help us in the process of disintegration of the USSR, which took place in a more civilized, without any great losses in economic and humanitarian spheres. Moreover, it positively managed regional conflicts among the newly independent young republics. However, the CIS never had the most important task in the economic integration. While EU worked together to combine, the CIS was created for a "civilized divorce". All the rest is political husk and empty chatter*."

[32] It should be noted that Ukraine, and other countries whose integration policies target Europe, will not be keen to build a customs union with predominant Russian influence (Golovnin, 2008).

Figure 2.3: The CIS as a main key framework for the development of further agreements



Source: own elaboration

However, from another side, it should be remembered that the CIS has been an organization with a generic or fundamental aspect for any other integration agreements as well as the condition for the emergence of new configurations of the interaction of the former Soviet Union. At this regard, Putin (2011) points out that "*namely, the CIS experience has enabled us to launch a multi-level and multi-speed integration in the post-Soviet space, create such required formats as the Union State of Russia and Belarus, the Collective Security Treaty Organization, the Eurasian Economic Community, Customs Union and finally the Common Economic Space*".

By 1995 it was clear that the creation of a single "geopolitical space" encompassing the entire CIS was not possible in the near future due to fundamental disagreements between their Member States on the purpose of their organization (Kembayev, 2014). This leads to divide this great alliance into different smaller integration groups (Figure 2.3). In

some sense, these initiatives tended to replicate the CIS model in a smaller format, something the development of the EurAsEC clearly illustrated it (Dragneva and Wolczuk, 2012).

1.3.3. From Central Asia integration to Eurasian integration

Along with other Central Asian countries, the interest of Tajikistan in integration projects in this region remains uncertain. In spite of several challenges like the nationhood building, transition period and civil war conflict, Tajikistan has shown especial interest in participation, but results were unsuccessful and there was not agreement between most of the region countries. Participating into several integration projects Tajikistan pursues different strategies depending on the conditions of the playing field and acting subjects (Laruelle and Peyrouse, 2013).

Firstly, it should be noted that agreements and organizations are combining in some way only five Central Asian republics, and that is not much. The literature of integration of Central Asia region Pomfret, (2004); Laruelle and Peyrouse, (2013); Kassenova, (2013) has shown that the main driving leader in establishing integration projects in this region is the President of Kazakhstan.

The development dynamics of integration processes of Tajikistan within Central Asia begins with the Central Asian Economic Community, (CAEC). This was the first Cooperation Organization which was established in 1994 when Kazakhstan, Kyrgyzstan and Uzbekistan signed an agreement on creating a Common economic space (CES). Tajikistan has joined it after overcoming the civil-war in 1998. In general, the results of the CAEC were more modest than expected due to the fact that the relations between the former Soviet republics have become less strong and each republic had no special desire to develop joint strategies with others (Kembayev, 2006; Laruelle and Peyrouse, 2013). In this sense, Pomfret (2004) referred to the CAEC as a forum for resolving disputes within Central Asia and had little in the way of practical achievements.

In 2002, with the changes in the regional geopolitical situation[33], four Member States have tried to give a new impulse to organization, turning its structure into the Central Asian Cooperation Organization (CACO). The main objective of transforming the

[33] Especially after the event that related with blast of bombs in Tashkent, the capital of Uzbekistan and changing situation in relation to Afghanistan and USA.

CAEC organization into the CACO was expanding cooperation from the purely economic organization to the cultural, humanitarian and political one as well as the creation of an integrating economic space and the coordination of foreign policy, particularly in the area of security in relation to Afghanistan (Kembayev, 2006; Kuzmina, 2012; Laruelle and Peyrouse, 2013). Unfortunately, in this case success was not attainable (Ushakova, 2003). Regarding to the non-fulfillment of CACO, Kembayev (2009) argued that this organization did nothing even in comparison to the CAEC, since it did not strive to eliminate even partially trade tariffs and barriers. Kuzmina (2012), supporting above studies, stressed that CACO performance was not lavish either. None of the three consortia (transportation consortium, food consortium and water consortium) has ever emerged in spite of efforts made by specialists of the World Bank, Asian and Islamic Development Banks in their creation.

Finally, with the entry of Russia in the EurAsEC in October 2004 and following to this the joining of Uzbekistan in November 2005, although left it in early 2008, the CACO automatically has merged with the EurAsEC (Kembayev, 2006; Kuzmina, 2012). In fact, in the same year at the meeting of leaders of CACO in Petersburg the members of the Central Asian Cooperation Organization made a decision to dissolve their organization and join to EurAsEC.[34]

Since the composition of both was almost the same, the unification of the CACO and EurAsEC was a logical step by encouraging the process of integration on the post-Soviet territory (Kembayev, 2006). The dissolution of the CACO and the EurAsEC emergence has made the Eurasian Economic Community the only feasible integration project not only in Central Asia but also in the entire post-Soviet area.

Thus, here the question raised is why after the signing of several agreements the Central Asian countries failed to create even one effective economic organization. Actually, from one side the Central Asian republics very early after the dissolution of the Soviet Union understood that they needed each other's reinforcements. Due to the fact that this landlocked region was experiencing significant problems in their development by remoteness from major world markets and heavy transport costs. Therefore, their solution for solving such problems requires regional integration. However, from another side, these

[34] However, countries, which were observers of the CACO (Georgia and Turkey), are not observers of EurAsEC.

Republics have greatly feared the loss of sovereignty once more, because they confused the Soviet integration with a new regionalism in terms of the global markets (as, the European Union) with different economic and political principles.

In addition, Central Asian countries never had a common interest and the experience for the formation of integration (Kuzmina, 2012). In other words, maybe these countries have become accustomed that Russia being always a "Big Brother" for them. A good example of this situation is what happened after Russia joined CACO turning into EurAsEC; as a result, none of the earlier Central Asian organizations worked (Laruelle and Peyrouse, 2013).

1.3.4. The Eurasian Economic Community (EurAsEC) Agreement

After an unsuccessful decade of economic integration within the Commonwealth of Independent States (CIS, 1991), the Eurasian countries under the Russia and in some extent Kazakhstan[35] initiative decided to reinforce their association at least among those CIS countries that were willing to create an effective integration through small format project like the Eurasian Economic Community (hereafter EurAsEC). This integration project was created with the idea of a "multi-speed" integration, as they did not want to repeat the CIS situation that faced many economic and political difficulties. Certainly, the agreement of Eurasian Economic Community is considered as one of the most important options for Tajikistan in the integration strategy within the post-Soviet area.

The Treaty on the Establishment of EurAsEC (which is currently transforming into the EEU, Eurasian Economic Union) was signed in Astana on 10 October, 2000 and came into force on 30 May, 2001, after being ratified by all the EurAsEC member states. Five states – Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan – have been members of EurAsEC since its formation. In 2006, Uzbekistan joined to the organization, ending participation in October 2008. Three countries have observer status: Ukraine, Moldova

[35] The President of Kazakhstan Nursultan Nazarbayev voiced the idea of the Eurasian Union of States for the first time at Lomonosov Moscow State University, during his first official visit to Russia on March 29, 1994. In June 1994, a detailed integration project was submitted to the Heads of the States and then published in the press. For the first time, the integration alliance was called "the Eurasian Union" in an official document (Eurasian Economic Union, 2015). http://www.eaeunion.org/?lang=en#about-history

since May 2002 and Armenia from January 2003. The Interstate Aviation Committee (IAC) and the Eurasian Development Bank (EDB)[36] have also this status (EurAsEC, 2013).

The EurAsEC as an economic integration project is the successor, firstly, of the Treaty establishing the "Customs Union" of Russia, Belarus and Kazakhstan in 1995, later joined by Tajikistan and Kyrgyzstan, and secondly of the Treaty on the "Single Economic Space" from 1999. Both documents were in the frame of CIS but in fact have remained on paper (Laruelle and Peyrouse, 2013). Only after 2000 a momentum built up for integration had real substance (Cooper, 2013).

Map 2.2: The map of Eurasian Economic Community (EurAsEc), 2000

*Source: Central Asia Research Group (*http://www.asiacentral.es/grupoub/mapas.php*)*

Many works underline that this project was inspired by the model of the European Union or an Eastern equivalent of the European Union[37] (Valovaya, 2012; Laruelle and

[36] The EDB is an international financial institution aimed to promote economic growth and integration processes in Eurasian space. It was established on the basis of an intergovernmental agreement between the Russian Federation and the Republic of Kazakhstan, signed in January 2006. Between 2009 and 2011, Armenia, Tajikistan, Belarus and Kyrgyzstan have joined it. The main directions of the financial activities of the bank are related to electro-energy, transport infrastructure, industry and high-tech industries. Since 2010, the EDB Bank manages EurAsEC Anti-Crisis Fund. One of the main objectives of the bank is to provide information and analytical support for the integration process. (See: http://www.adb.org/about/main).

[37] Examining the institutions and the progression of stages of the envisioned EEU, one can easily notice a striking similarity with the process of European integration, which led to the creation of today's European

Peyrouse, 2013; Cooper, 2013). As many other integration groups, EurAsEC also has its basic objectives or tasks which include: implementation of the free trade regime; the formation of a common customs tariff and a common system of non-tariff regulation measures; the creation of a common financial market; and the coordination of principles and conditions for the common currency.

It ensures also economic security at the external borders of the Community and develops a coordinated position of the member States in their relations with the WTO and other international economic organizations along with establishing a common transport system as well as the formation of a common energy market.

The project was created to effectively advance the process of forming the "Customs Union" and "Common Economic Space" by member states, as well as, to implement other goals and objectives connected with the enhancement of integration in the economic and humanitarian spheres. The idea was that the EurAsEC should also ensure the free movement of citizens of member states, and coordinate social policy in order to guarantee a common labor market. It should also harmonize national systems of education, developing science, culture and a common approach to health. Moreover, the final goal of the EurAsEC is the creation of a customs union and an economic union between the member States.

This is an accurately structured system with a firmly established mechanism for adopting and implementing decisions (EurAsEC, 2013). Unlike previous initiatives, some of the EurAsEC members moved to a new phase of integration, of course under the leadership of Russia. The first phase of this new project, **the Eurasian Customs Union (CU)**, with the participation of the three countries -Belarus, Kazakhstan and Russia- began in July 2010. These countries have accepted common rules and procedures regulating the mutual trade, and set up a common customs union[38]. In July 2011, they abolished customs

Union. However, the legal nature of both integration groupings is completely different: while the EU is in principle an association of (mostly) parliamentary states with a significant degree of decentralization, the Eurasian alliance is a union of highly centralized presidential republics. Therefore, the present time (especially in light of the recent proliferation of integration processes in Eurasia) is characterized by the competition of two opposite models of regional integration (Kembayev, 2014).

[38] The ECU Commission and Secretariat undertook a considerable volume of work to establish common rules of the game on many issues relating to external trade. There has been considerable progress in moving towards single systems of trade regulation, sanitary, veterinary and phytosanitary controls, technical regulation and protective measures. By the beginning of 2012 it could be considered a

controls at their common borders. After the formation of the "Customs Union" the rating of this project is increased. Golovnin, 2008 has properly claimed that without a customs union EurAsEC will become indistinguishable from other more amorphous formations (as for example, the CIS).

The second stage led by the principle of multispeed integration started in January 2012, with the creation of the **Common Economic Space (CES)**.[39] Its mission is to develop the well-functioning of the common market of goods, services, capital and labor; to coordinate fiscal, monetary, foreign exchange, trade, customs and tariff policy; development of common transport, energy and information systems. Since 2009, Russia has taken the ruble in the trade with Kazakhstan and Belarus, and recently renewed talk of a possible creation of a monetary union. The three member states were interested that the ECU project take place within a wider framework for advanced economic integration – a single economic space, followed by an economic union. Consequently, the full "Economic Union" has begun in January 2015.

Basically, this organization is able of solving many issues of economic integration in terms of today's requirements. Many studies have stressed that today the Eurasian Economic Union (EurAsEC) is the most successful and advanced union among all integration projects which appeared in the post-Soviet area (Pomfret, 2004; Dragneva and Wolczuk, 2012; Kuzmina, 2012; Libman and Vinokurov, 2010; Kembayev, 2014; Galiakberov and Abdullin, 2014; Yesdauletova, 2014).

In this sense, the President of the Russian Federation V.V. Putin said: "*It is not an overstatement to say that EurAsEC is the most successful integration union of the CIS space. The Community has carried out all the tasks at hand: the Customs Union has begun its work, the Common Economic Space of the three countries has been launched, their unified regulatory standing body – the Eurasian Economic Commission – has been created*", (EurAsEC today, 2013).

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functioning customs union, although much work remained to complete the process and ensure its fully effective operation (Cooper, 2013).

[39] A powerful integration breakthrough was made in 2010. In just one year the heads of states drew up and signed a package of basic agreements, which enabled the establishment of the Common Economic Space (CES). It was ratified in 2011, and on 1 January 2012 the practical phase of the forming of CES was launched. There are 9 interstate targeted programs and 11 concepts being developed and implemented in EurAsEC. The following institutions are actively working in the Community: the Anti-Crisis Fund, the EurAsEC Centre for High Technologies and the Eurasian Business Council (EurAsEC today, 2013).

Similarly, Dragneva and Wolczuk (2012) have mentioned that until recently regional integration in the post-Soviet space was largely declarative. But the Eurasian Customs Union (ECU), the latest initiative,[40] appears more viable thanks to its better institutional framework, it has proven commitment to implementation and introduction of a system of rules harmonized with international norms and the WTO regime. Kuzmina (2012) also has claimed that EurAsEC countries have the best integration pace, since the CU emerged as a milestone that is even able of changing negative trends in development of post-Soviet states economic cooperation. Libman and Vinokurov (2010) referred to the customs union of the EurAsEC as "the only truly functioning integration institution in the Former Soviet Union".

Moreover, Galiakberov and Abdullin (2014) showed that integration of post-Soviet countries based on EurAsEC is more successful than integration based on the CIS model despite the lack of supranational power of the institutions of EurAsEC. In the same way, Yesdauletova and Yesdauletova (2014) have stressed that The Eurasian Economic Community was the real integrative force in the post-Soviet space, with the formation of the Customs Union EurAsEC represented the highest level of integration within this area in the new century. In regard to the legal aspects, Kembayev (2014) has expressed that in contrast to the CIS the EurAsEC was clearly endowed with the necessary legal capacity to exercise its functions and fulfill their objectives. Pomfret (2004) has distinguished the difference of the functional areas of this new Community from those agreed within the previous frameworks even in the earlier stages of the EurAsEC. The emphasis is on free intra-Community trade as well as a common market for labour and capital, common policies towards migration, and more general policy harmonization. He has claimed that its specific intention was to coordinate WTO accession negotiations.

However, it must be noted that the EurAsEC "weighted" voting principle could be a problem for small countries.[41] Russia has the strongest voice in adopting the EurAsEC

[40] This initiative, which offers a forward-looking, advanced form of economic integration, has serious implications for EU–Russian relations in general and the EU's strategy in the post-Soviet 'shared neighbourhood' in particular. The ECU is clearly seen by Russia as a vehicle for reintegrating the post-Soviet space, including the countries that fall within the sphere of the EU's eastern neighbourhood ' (Dragneva and Wolczuk, 2012).

[41] The EurAsEC had drafted mechanisms to coordinate the interests of member countries and had adopted the principle of "weighted" voting, which is based on the proportional contribution of each country to the Community's budget. Thus, Russia has 40 percent of the voting rights and is responsible for 40 percent of operating expenditures, Belarus and Kazakhstan have 20 percent each, Kyrgyzstan and Tajikistan 10

decisions and the fact of Russia's greatest weight is a problem in any association in the post- Soviet space (Golovnin, 2008). Nowadays between Tajikistan and the EurAsEC members exists a free trade zone and relatively free people movement (with the absence of visa controls within most participating countries). On the other hand, Tajikistan still not entered into the Customs Union of EurAsEC, although it is on the eve of the accession to deeper stages of this union. Recently, the creation of a customs union is attracting issue in Tajikistan due its importance to formal integration process. The timely and successful decisions on this issue would bring about an effect on the future of the Tajikistan and EurAsEC as the most advanced integration project in the ex-Soviet orbit.

There is a significant factor that distinguishes this process from other experiences of regional economic integration. Unlike the development of the European Union, NAFTA, Mercosur or similar groupings, economic integration in the former Soviet space is more in the nature of re-integration (Cooper, 2013). These were countries with a common past in the Soviet Union, with a shared economic system, common infrastructures in relation to energy, transport and communications and the same educational research and development systems. They also shared a common administrative language, Russian, and this is still to a large extent the case today. Thus, in principle, integration should be easier for these countries, and perhaps more rapid once initiated on an appropriate basis, than it was for the EU or Mercosur. However, there is an important political difference. Inevitably, Eurasian integration is asymmetric, Russia being the dominant party in terms of territory, population, economic strength and military might. A Russian leadership from a position of strength will have a negative impact on prospects for successful integration. As the dominant economy, there is also a danger that any negative developments in Russia will have spillover effects in the smaller economies of the region.

1.3.5. The EurAsEC economic context: An overview

The Eurasian Economic Community (formed by Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan) covers a territory of 20.374 m sq km which represents one of the world's largest areas (15% of the inhabited land) with about 182.6 million inhabitants in

percent each. Apart from Russia, this distribution of voting share by budget contribution gives more rights to each country than if other indicators had been used, for example, population, size of economy or industrial output, (Golovnin, 2008).

2013 (3% of the world population). In 2011 the Community produced about 4,5% of global GDP and accounted for about 3% of world exports (EurAsEC today, 2013).

Thanks to its geographical position, located on the route between China and the EU, the EurAsEC countries have a great potential to become the transit countries for intra-eurasian trade and playing the role of "bridge" between Europe and Asia. From an economic point of view, this regional integration group is a major regional market with a vast mineral useful resources, raw materials, and significant economic potential. The integrating countries account for more than 20% of the world's fresh water reserves and forest cover of the planet (EurAsEC Today, 2013).

The Community ranks 1st to 3rd in worldwide resources of industrial uranium, raw diamonds, palinodes, gold, silver, zirconium, rare metals, rare earth elements and many other useful minerals. EurAsEC countries are among the main exporters of mineral resources and metals to the global market and with regard to oil and gas, chrome and manganese resources, aluminum and others they play leading roles among exporting countries. The main part of the gas resources, oil and coal are in Russia. Kazakhstan also has significant reserves of oil and coal. Small oil and gas reserves have been explored in Belarus, Kyrgyzstan and Tajikistan; coal in Kyrgyzstan and Tajikistan. Considerable reserves of hydropower have Russia, Kyrgyzstan and Tajikistan. In 2011, the Community members possessed 7.5% of the world's prospected oil resources, 22% of gas and coal, their share in the generation of electrical energy was 5.5%, steel production amounted to 5.1%, and grain production was at 5.9%, (EurAsEC today, 2013).

1.3.6. Main Economic Indicators

The EurAsEC five former Soviet Union territories can be divided into two sub-regions: North and South. The first one is formed by the northern Kazakhstan, Russia and Belarus. These countries are economically linked quite close and they constitute the more developed part of the EurAsEC. The second sub-region consists of the South Kazakhstan, Kyrgyzstan and Tajikistan. They are less developed economies and Uzbekistan[42] plays an important role in their economic relations (Dergachev and Vardomskiy, 2004).

[42] Uzbekistan represents an example of the prevalence of the narrowly defined 'electric power security' over an economically more beneficial regime of transboundary electricity flows within existing regional power systems. This country withdrew from the Unified Energy System of Central Asia (UES-CA) on

Although these territories share a common heritage as former Soviet Union, they are heterogeneous by both the nature and depth of economic reforms implemented as well as in terms of political dimensions, in the size of territory, availability of mineral resources, population, and level of economic development. After the deep socio-economic recession linked with a break of economic relations as a result of the Soviet Union collapse and the transition period, EurAsEC countries achieved economic recovery only by the 2000s. In more developed part of the Community were held economic stabilization programs. At the same time, the less developed part, Kyrgyzstan and Tajikistan, managed to improve their economies thanks to financial assistance rendered by international community (Kuzmina, 2012). Consequently, all integrating members showed high economic growth rates in 2000: Russia and Kazakhstan recorded about 10% average annual real GDP growth, Belarus (5.8%), Kyrgyzstan (5.4%) and Tajikistan (8.3%) (Table 2.1).

Definitely one of the main drivers of economic growth in most of the EurAsEC countries in these years was the upswing prices of raw materials, namely, oil, gas and cotton. Nevertheless, economic growth in these countries occurs in a background of considerable technological backwardness and low levels of competitiveness (Namoz, 2014). As a clear example, the economic growth in Tajikistan is uncertain due to the high reliance on external factors like the high dependence on remittances, accounting by above 50% of GDP in 2013 (according to World Bank Indicator Data). A similar situation can be observed in the case of Kyrgyzstan. In 2013 the economic growth rates slowed in all member countries, with the exception of Kyrgyzstan. The most negative effect was for Russia and Belarus. Tajikistan is not excluded from this, but its economic growth rates decreased not as much as other members, remaining in rates above 7% (Table 2.1).

December 1st, 2009. This unilateral act was apparently planning for two years, as the Uzbek power system was getting interconnected. Because of Uzbekistan's central position, all Central Asian countries have been hit by this decision; Tajikistan, however, may be the worst affected. For the last 70 years, Tajikistan has received a substantial proportion of its power supplies from neighboring Uzbekistan (its energy deficit in the fall-winter period constitutes around 2bn kW/h; this is covered by 0.6bn kW/h of Uzbek energy and 1.2bn kW/h of Turkmen energy transited through Uzbekistan). Over the same period, Tajikistan has exported comparable amounts of electricity to Southern Uzbekistan in the spring-summer season, in the process of irrigating land located downstream on major rivers (Libman and Vinokurov, 2010).

Table 2.1: Main socio-economic indicators of EurAsEC member states (2000 -2013)

	BLR	*KAZ*	*KGR*	*RUS*	*TAJ*
		2000			
Population ***(millions of residents)***	10.05	14.88	4.89	146.59	6.18
GDP ***(current million U.S dollar)***	12736.8	18291.9	1369.7	259708.5	860.5
GDP per capita ***(current U.S dollar)***	1273	1229	279.6	1771.6	139.1
Economic growth ***(percent of real GDP)***	5.8	9.8	5.4	10	8.3
Industry ***(as percent of GDP)***	39.2	40.5	31.4	38.0	38.9
Agriculture ***(as percent of GDP)***	14.2	8.7	36.7	6.5	27.4
Service ***(as percent of GDP)***	46.6	50.8	31.9	55.5	33.7
Inflation, GDP deflator ***(annual %)***	185.3	17.4	27.2	37.7	22.7
Capital Investment ***(as percent of GDP)***	25.4	18.2	20.0	18.7	9.4
FDI ***(as percent of GDP)***	0.9	7.0	-0.2	1.0	2.7
Foreign Trade****(million U.S dollar)***	15977.8	13579.1	1058.6	147954.7	1429.0
Trade Balance ***(million U.S dollar)***	-1315.1	+3725.9	-49.6	+58230.7	+141.0
		2013			
Population ***(millions of residents)***	9.46	17.03	5.71	143.49	8.20
GDP ***(current million U.S dollar)***	73.097,6	23.1876,3	7.335,1	2079024.8	8506.6
GDP per capita ***(current U.S dollar)***	7722.1	13611.5	1282.4	14487.3	1048.7
Economic growth ***(percent of real GDP)***	0.9	6.0	10.5	1.3	7.4
Industry ***(as percent of GDP)***	42.3	36.9	26.7	36.3	21.8
Agriculture ***(as percent of GDP)***	9.2	4.9	17.7	4.0	27.4
Service ***(as percent of GDP)***	48.5	58.2	55.6	59.7	50.8
Inflation, GDP deflator ***(annual %)***	18.1	6.0	7.9	7.2	5.5
Capital Investment ***(as percent of GDP)***	38.7	26.2	31.7	22.6	19.1
FDI ***(as percent of GDP)***	3.1	4.2	10.5	3.4	1.3
Foreign Trade****(million U.S dollar)***	81225.8	133503.1	7756.3	842211.0	5291.0
Trade Balance ***(million U.S dollar)***	-6819.6	+35893.9	-4209.9	+212320.8	-3010.4

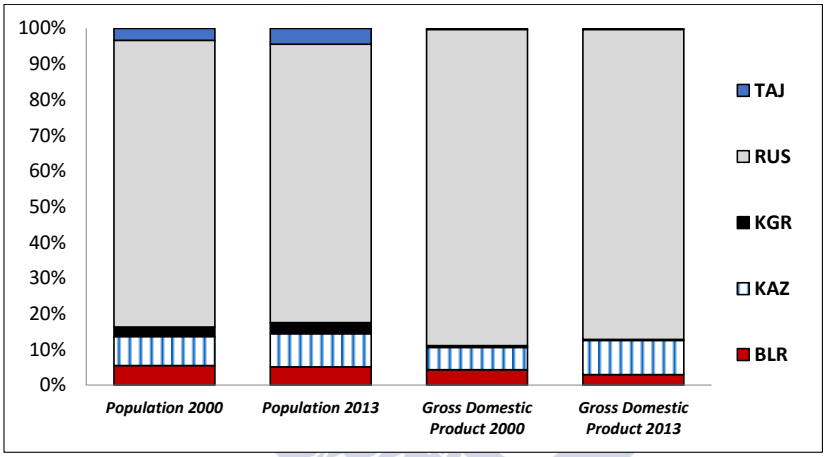
*Source: Own elaboration based on World Bank Data 2015, *data from UNCDAT, 2015*
***Note: BLR**-Belarus, **KAZ**-Kazakhstan, **KRG**-Kyrgyzstan, **RUS-Russia, TAJ**-Tajikistan*

These countries have a positive short-term economic growth and if they overcome some factors such as depending on very few raw materials and high remittance and if they diversify exports, they could continue high-growth rates in the long term. Russia is the leader among all other countries with a large consumer market (a population made up of about 78% of EurAsEC); while Kazakhstan, as the second largest country, has 9.2% of population. In spite of the significant population growth observed in the case of Tajikistan,

in terms of territory and population size Kyrgyzstan and Tajikistan are incomparable with the other members.[43]

The EurAsEC members are also quite diverse in terms of their GDP size, Russia representing the 88.6% of the total GDP in 2000 is clearly the leader, followed by Kazakhstan (6.2%) and Belarus (4.3%); while Tajikistan (0.29%) and Kyrgyzstan (0.47%) are almost negligible. In 2013, Russia (86%), Belarus (2.9%) and Kyrgyzstan (0.29%) decrease their share, while Kazakhstan (9.5%) increases. The share of Tajikistan also increases but it continues being negligible with a 0.35% of the total GDP (Figure 2.1).

Graph 2.1: Share in total population and GDP of EurAsEC, 2000 and 2013



Source: Own elaboration based on World Bank data

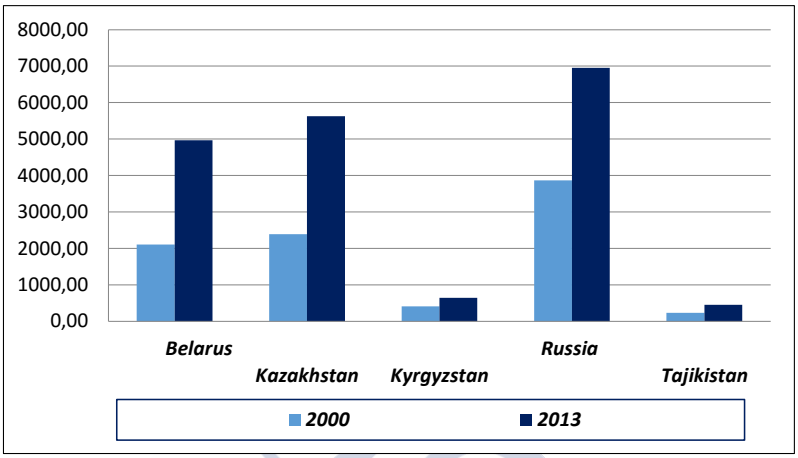
The comparison of the members regarding the share of the economic sectors in GDP also shows two groups of countries within the EurAsEC: Russia, Kazakhstan and Belarus have a relatively well-developed industrial base while Tajikistan and Kyrgyzstan have a important weight of the agricultural sector. Recently the share of service sector increased significantly almost in all countries (Table 2.1).

In terms of GDP per capita, it can be observed that there was an important improvement in all member countries between 2000 and 2013. At current prices and exchange rates, the per capita GDP of was multiplied from by 4.5 in Kyrgyzstan to by 11 in Kazakhstan. However, GDP per capita in Tajikistan is only 7.8% of that of Russia in 2000 and falls to 7.2% in 2013. These increases are not as large when data are taken at

[43] Considering the size of the union as population size, Tajikistan will surely benefits from this integration, as it is over populated in spite of being the smallest country in the union (Hosny, 2013).

constant prices and exchange rates (Figure 2.2). In this case, GDP per capita of Tajikistan is only 6% (2000) and 6.5% (2013) of that of Russia.

Figure 2.2: GDP per capita, US$ at constant prices (2005) and constant exchange rate (2005)



Source: Own elaboration based on data from UNCTAD

The integrating members are not so successful on attracting of FDI due to the poor institutional development and unfavorable business environment. The highest FDI inflow corresponds to Kirghizstan with 10.2% of GDP. The foreign trade turnover displays very high volume in 2013 comparing with 2000, almost in all these countries. According to (EurAsEC Today, 2013) the share of this regional trade agreement in world trade remains quite high (3% of world exports and 4% of world GDP). But, certainly, given such a huge economic scale the trade turnover of Russia is significantly huge between other EurAsEC members or even incomparable, especially with the small countries. In fact, Russia accounts by 78% of the whole union foreign trade, while the second one country, Kazakhstan, accounts by 12%. Both countries are the only ones in showing a positive trade balance.

In general, EurAsEC member's economies have huge opportunities for development through their richness in natural and mineral resources. Despite this, the macroeconomic indicators show that they should be concerned about extending investment rates and higher FDI related to the structure of its member countries' economies. One of the main economic problems which EurAsEC must resolve is the structure of its member

countries' economies. [44] It has to be improved in order to increase the competitiveness of these individual countries and that of the whole Community within the global economy. The existing structure of the EurAsEC economies, among which only Russia and Belarus can boast substantial manufacturing sectors, is an obstacle rather than an asset to integration (Golovnin, 2008).

At the same time, another worrying factor for successful economic integration within these countries is a high divergence between economies of larger and smaller countries. Eurasian countries can facilitate this issue only through the investment effort to the small countries in the terms of availability resources in each country. For instance, in the case of Tajikistan, it would be possible to have an enormous growth through expanding investment for the potential sectors, like energy generation[45] or agriculture (Vinokurov et al, 2013).

The potential effects of EurAsEC on Tajikistan, explaining the decision of this country in prioritizing this option of economic integration will be discussed in chapters three and four. Before, in next sections, we will discuss the other options also followed by Tajikistan in its integration strategy.

1.4. Further development in the Global Market

Bearing in mind the importance of the integration to the global market as an engine of growth, the integration to the global organizations and international financial institutions has been another relevant option for the foreign policy of Tajikistan. The UN was the first international organization being present in Tajikistan, in March 1992, starting with the UN

[44] The EurAsEC member countries have remarkable differences in the structure of their domestic economies. For example, Russia and Kazakhstan are major exporters of raw materials and produce a very wide range of goods (especially Russia), while Belarus specializes in producing finished goods from raw materials imported from third countries. Kyrgyzstan and Tajikistan, which lag behind other EurAsEC member countries in terms of industrial production, are importers of a large number of industrial goods from non-CIS countries. Because of this, Russia is keen to protect its economy by using duties on a wider range of products than would its EurAsEC counterparts. In addition, since the average weighted rate of customs duties in Russia is falling, Russia levies lower import tariffs on some goods than its partners do. Kazakhstan's customs tariffs differ considerably from those of Russia and Belarus, the Kazakh economy is liberalized to a larger extent (Golovnin, 2008).

[45] Of a fundamental importance to Tajikistan and Kyrgyzstan is an agreement signed by heads of EurAsEC states regarding joint development of Central Asian water resources, which allows increasing investment inflow from Russia and Kazakhstan (Kuzmina, 2012).

Tajikistan Office for Peace-building (UNTOP). Beginning from 1993, the UN has increased its presence to 21 specialized agencies, funds and programs of the UN and World Bank. The aim of the UN in Tajikistan is to assist the Government in implementing the Country Development reforms and provide support in the achievement of the Millennium Development Goals by 2015. The International Monetary Fund (IMF) and International Finance Corporation are also active in Tajikistan and are collaborating with the UN Country Team (UNCT)[46]. One year later, in April 1993, Tajikistan became member of the International Monetary Fund (IMF)[47] and in June of the same year it became member of the World Bank[48], which includes the International Bank for Reconstruction and Development (IBRD), International Finance Corporation (IFC) and International Centre for settlement of investment disputes (ICSID).

Together with the other countries in the region, Tajikistan also was actively involved in a number of regional financial institutions, being the only country that are member of both the European Bank for Reconstruction and Development (EBRD) [49], since 16 October 1992, and the Asian Development Bank (ADB), since 1998. ADB is Tajikistan's largest multilateral development partner and plays crucial role in the country's aid position with ongoing necessary reforms[50]. In November 1996, Tajikistan joined the

[46] Tajikistan also participates in the activities of the main United Nations agencies (UN) such as the United Nations Educational, Scientific and Cultural Organization (UNESCO), the International Labour Organization (ILO) and the World Health Organization (WHO). In addition, UN realized a number of special programs in the region of Central Asia, including Tajikistan. These programs are the Special Program for Economies of Central Asia (SPECA) and the United Nations Office on Drugs and Crime (UNODC). The European Union also is funding two programs that are implemented by the regional subdivisions of the United Nations Development Program (UNDP) as the program to promote in border management in Central Asia (BOMCA) and Central Asia Drug Action Program (CADAP). http://www.untj.org/index.php?option=com_content&view=article&id=79&Itemid=498

[47] See: http://www.imf.org/external/np/sec/memdir/memdate.htm

[48] See: http://www.worldbank.org/en/country/tajikistan/projects

[49] The EBRD with 102 projects in Tajikistan is focused on stabilizing and rebuilding trust in the banking sector, developing private enterprises and agribusiness, improving the availability and quality of municipal services and regulation and energy efficiency. The cumulative EBRD investment accounts for about €566milion, the current portfolio of projects for €336 million and the 29% private sector share of portfolio. (http://www.ebrd.com/tajikistan.html)

[50] The ADB updated 2016-2018 country program in Tajikistan aims to support inclusive economic growth through structural reforms to strengthen the investment climate, road, energy development and improved food security. http://www.adb.org/countries/tajikistan/main

Islamic Development Bank (IDB) and finally the young Eurasian Development Bank (EDB) [51] welcomed Tajikistan as a member in June, 2006.

Thus, trying to develop an environment of open economy, the Tajik accession to the WTO would be a natural institutional simulation to economic openness. However, after independence in 1991, Tajikistan together with other post-Soviet countries were suspicious regarding the international commitments of WTO which restrict their home policy rules. Tajikistan was pleased of entering the United Nations as a signal of nationhood, to join the IMF and World Bank and the several above mentioned regional development banks as potential sources of capital, however it held back on WTO accession until 2013.

1.4.1. The accession to the World Trade Organization (WTO)

After an increasing number of regional trade agreements becomes evident the question concerning their compatibility with WTO principles. Consequently, the main locomotives of development foreign trade are becoming regional integration groupings in parallel with WTO rules.[52] Considering the importance of the further integration of the country into the world economic relations as well as the improvement of trade and promotion of economic development and poverty alleviation, on 29 May 2001 the Republic of Tajikistan submitted an application to join the WTO membership under Article XII. The Working Party on the accession of Tajikistan was established by the General Council on 18 July 2001, and since its establishment the Working Party of Tajikistan has met 4 times. The country completed its membership negotiations on 26 October 2012 when

[51] In autumn 2009, several months after the Tajikistan accession to the Eurasian Development Bank, the Bank financed the establishment in Tajikistan of high-quality cotton yarn production facility with 5 thousand tons per year production capacity. Olymp-Textile CJSC affected the construction project of the spinning factory. EDB's contribution to the project amounted for US$ 22.57 million over a total investments of US$ 29.75 million. In the framework of its investment activities in 2013–2017, EDB will provide assistance in developing export-oriented enterprises; will facilitate agriculture diversification and productivity improvement; and will participate in addressing the issues of food security. Taking into account the importance of the transport infrastructure for the country's economy, EDB stands ready to support projects aiming at: servicing foreign trade; improving the quality of transport services and logistics; and the renewal of vehicles and fixed assets. http://eabr.org/e/about/edb-member/tajikistan/

[52] According to WTO rules, in particular the most favored nation treatment (MFN), such regional groups as EurAsEC destroys the multilateral principles by dividing the world into discriminatory segments, artificially changing the "natural" specialization and flows of goods. However, supporters of regional arrangements argument those integration agreements bring the common benefit, whereas stimulating the liberalization of global economic relations. Regional integration as "building block or stumbling block" is from a long time until now an "open question" of debate.

the Working Party adopted the accession package. The General Council approved the accession on 10 December 2012. Once after 11 years, when completing its domestic ratification procedures on 2 March 2013, Tajikistan became the 159th full-fledged member of the WTO family (WTO, 2013).

Associated with this, Tajikistan's President, Emomali Rahmon declared "*Today constitutes a landmark in Tajikistan's history and lays solid foundations for further promotion of sustainable social and economic growth. Applying for WTO membership 11 years ago was the right step forward for Tajikistan as it transforms itself into a market economy. Tajikistan will use its WTO membership as a means of fostering future economic growth and prosperity. The WTO accession has been a major instrument for pursuing Tajikistan's main strategic goals as to achieve energy independence, food security and to tackle communication deadlock challenges it faces as a land-locked country. The immediate objectives of this process have been the establishment of a market economy, a friendly- investment environment, and integration in the global economy*". [53]

Moreover, Director-General Pascal Lamy said: *"For Tajikistan, a small and landlocked country, WTO accession is a road leading to the world economy. For the WTO, it is another step towards universality and a sign of confidence in the values and benefits of the multilateral trading system"* (WTO, 2012).

The first Deputy Minister of Economic Development and Trade of the Republic of Tajikistan Mr. Saidrahmon Nazriev[54] refers to Tajikistan's WTO membership as one of the priority issues of the economic development of the country, which first and foremost actively contributes to the process of integration into the global economy. It has a positive effect on the country's rating at the global level, makes it possible to take advantage of multilateral trading system and contributes to the improvement of the structure of government administration related to the highly qualified specialists. Membership in this organization allows Tajikistan to implement the system of transparency, predictability, and most importantly compliance with the requirements of the global trade market access as well as to increase the competitiveness in the domestic market. In order to exploit full

[53] See: Statement of the President of the Republic of Tajikistan in World Trade Organization. http://wto.tj/en/press-centr/video/292/

[54] See: Speech of the First Deputy Minister of Economic Development and Trade of the Republic of Tajikistan Mr. Saidrahmon Nazriev. http://wto.tj/en/press-centr/news/359/

advantages of the WTO membership and to recognize its membership commitments, Tajikistan has undertaken several internal reforms and measures.[55]

Accordingly, due the basic WTO principles and by being a member of this organization, first, Tajikistan can take advantage of a most favored nation treatment from all WTO partners, especially with the main Tajikistan trading partners like China, Russia and Turkey, which are also members of WTO. But also it can get wider access to foreign markets by diversifying its trade in different geographical locations. Third is the simplification of the administrative intervention of the trading environment in terms of removal of non-tariff barriers. Finally, accession to the WTO also may have the positive influence for banking and financial sector relating to the FDI, including the newest technologies (Kayumov and Umarov, 2004; MEDT, 2008). Moreover, these studies have claimed that another main benefit is related to the dispute settlement mechanism of the WTO, which offers the opportunity of solving such issues, providing a strong incentive for the accession of small and weak countries to the WTO.

However, it was recently noted by Director-General Roberto Azevêdo that "WTO membership is not an end in itself". A realization of the benefits of WTO membership is not automatic; it is inter-dependent with sustained domestic reforms and the implementation of the obligations and commitments of membership (WTO, 2015). Although, Tajikistan has agreed to undertake a series of important commitments to further liberalize its trade regime, it is difficult for such less developed country implementing all its commitments. Usually small countries such as Tajikistan enter the WTO platform just with the aim of searching a haven from the worst external events, strengthening its reputation in the world, and creating favorable conditions for the attraction of foreign investment, but they held back because of WTO negative effects and number of commitments.[56]

[55] The year 2015 will be noted in Tajikistan's history as a remarkable year as the Government of Tajikistan adopted the Program of adjustment of the economy of Tajikistan to the WTO membership. The Parliament has ratified both the WTO Trade Facilitation Agreement and the Protocol of amendment of the TRIPS Agreement, and also hosted the Dushanbe Third China Round Table on WTO accessions. For Tajikistan, like for other land locked countries, the implementation of TFA Agreement and in particular its transit related provisions, is not only a question of commercial interest but a matter of survival (Nazriev, 2015).

[56] The First Deputy Minister of Economic Development and Trade of the Republic of Tajikistan Mr. Saidrahmon Nazriev in the Doha Development Round (2015) calls upon the WTO membership to redouble their efforts towards a successful conclusion of the Round with the main focus on development

In the light of this, many countries are linking their hopes to development of foreign trade with the WTO accession, presenting it as “magic wand” which removes all obstacles and leads the country to be the world leader in the trade field. In this regard, Tajikistan also is not an exception since it becomes the 159th member of WTO, but this hope that Tajikistan access the WTO was not justified (Petrushkow, 2015). Petrushkow has claimed that, one can absolutely believe that WTO membership for countries can improve its exports, enhance competition, promote cost competitiveness, and increase integration in the multilateral trading system and FDI inflows. However, as clearly shown "stubborn numbers", the high expectations related to the country's accession to the WTO and the delaying participation process of Tajikistan to the deeper stage of EurAsEC as “Customs Union” or “Eurasian Union” has negative impact to the performance of foreign trade of the country.

From another angle, this situation may be only coincident with WTO accession, as the experience of Kyrgyzstan whose any negative shocks to their economy are regarded as being related with the negative effects of the WTO accession (Pomfret, 2004). Certainly, Tajikistan also has negative effects from accession of the WTO, as Kayumov and Umarov (2004) have argued membership of the WTO for developing countries entails not only benefits but also significant economic and social costs.

Moreover, according to MEDT (2009), the public budget loses incomes through reducing import duties and decreasing protection of a number of sectors of the national economy. The Republic will lose the option of protecting the domestic market through limitations on foreign trade. In addition, entering the WTO will damage small and medium-sized businesses due to their uncompetitiveness with imported goods and services. The realization of such world institution reform in a short period of time cannot take place without capacity building and significant technical assistance, as well. Hence, the unsteady and vulnerable economy of Tajikistan certainly failed to profit much from immediate benefits through WTO membership, though it is difficult to show that it suffered from accession to this organization.

In this way, today Tajikistan should realize that accession to the WTO not only might bring benefit from MFN treatment and from the removal of restrictive trade barriers

and with meaningful results for the developing countries and LDCs, as well as on the special situation of the recently acceded members who have undertaken extensive market access commitments.

applied to the country in global market. Together with these, the country faces many commitments[57] concerning a multilateral trading system as well as in the way of entering the integration group EurAsEC. Therefore, the assessment of the economic impact of regional integration of the countries in the multilateral trading system is ambiguous. Thus, in order to develop trade flows and come to effective integration in the frame of the world economy, Tajikistan should take concrete steps toward modification trade and foreign economic policy. Moreover, it should undertake the improvement of the institutional and legislative base for full compliance with the standard requirements, and measures of international trade relations.

1.5. The Integration with the Outside "Ex-Soviet" Orbit

The third integration option of Tajikistan is by signing agreements with an outsider of the post-Soviet Orbit as its Southern neighbors and China. As we mentioned above, Tajikistan tries to insert itself into the global economy in different ways, being actively involved not only within the post-Soviet space or by join a number of international organizations and financial institutions and other European transatlantic regional organizations, but also by its participation in several agreements with the Islamic World and China.

1.5.1. Integration with the Islamic World

Since Islam is the most widespread religion in Tajikistan, Tajikistan is seeking to strengthen its status in the Islamic world after the collapse of the Soviet Union. The country joined into a number of key institutions whose membership is based on the full or partial identification with Islam. Thus, Tajikistan has pursued the insertion into the Islamic world organizations with the development of various economic integration options in parallel, in particular, with the Organization of Islamic Cooperation (OIC) and the Economic Cooperation Organization (ECO).

[57] Recently acceded members (RAMs) or Article XII Members, ie, countries that negotiated and joined the WTO after 1995, seeking lesser commitments in the negotiations because of the liberalization they have undertaken as part of their membership agreements.
See:https://www.wto.org/english/tratop_e/dda_e/negotiating_groups_e.htm

The Organization of Islamic Cooperation (OIC)[58] was founded in 1969 as the Organization of the Islamic Conference. In 2011 was renamed as the Organization of Islamic Cooperation. The objectives of the Organization are the protection of the vital interests of the Muslims; the resolution of conflicts and disputes between Member States; development of economic and trade partnership and elaboration of a framework for economic integration in the form of an Islamic Common Market. This organization is supporting partnerships with the UN and other intergovernmental organizations. Currently it brings together 57 countries, including Tajikistan.

The Economic Cooperation Organization (ECO)[59] was founded by Iran, Pakistan and Turkey in 1985. It is the legal successor of the Regional Cooperation for Development Organization (ORSR), established in 1964, the same three (at that time pro-American) Muslim states.

Map 2.3: The Economic Cooperation Organization (ECO), 1985

*Source: Central Asia Research Group (*http://www.asiacentral.es/grupoub/mapas.php*)*

It promoted economic, technical and cultural ties between the member States. After the collapse of the Soviet Union, Tajikistan with other four Central Asian republics, Azerbaijan and Afghanistan joined the ECO. The objectives of its activities include the promotion of sustainable economic development of Member States, the gradual

[58] See: www.oic-oci.org/
[59] See: www.ecosecretariat.org/

elimination of trade barriers and the promotion of intra-regional trade. Other objectives include increasing the role of ECO region in the development of world trade, fostering the rational use of resources in the region, promoting both regional cooperation in struggling drug abuse and environmental protection as much as strengthening historical and cultural ties between people of the region.

1.5.2. The new regional platform in the context of a "peaceful rise of China"

As a beginner which dramatically changed the geopolitical and economic position in Central Asia, and as a model measuring by all other external actors, China has quickly become a key player on the regional scene. Even Beijing, which is traditionally accenting bilateral relations, in this case began to experiment with the new regional platforms. Today the Central Asian region is acknowledged as the driving force, ensuring the "peaceful rise of China" that contributes to diminish the concern of the international community, (Goldstein, 2005).

The Shanghai Cooperation Organization (SCO)[60] , which was initiated by China, is another prominent integration organization outside the strict scope of post-Soviet Area that includes Tajikistan. The Republic of Tajikistan during the meeting held in China on 21 December 2001 becomes founding member.

The SCO is the successor of the "Shanghai Five" Organization, founded in 1996 for resolving border disputes inherited from Soviet times between China and the four post-Soviet states - Russia, Kazakhstan, Kyrgyzstan and Tajikistan. The entrance of Uzbekistan in 2001 has become the symbol of the status change from "Five" to the SCO as well as the displacement of the accent from the demarcation of borders to the regional security issues. In 2004, Mongolia received the status of observer in the SCO. In 2005, Iran, India and Pakistan got such a status and in 2012 Afghanistan. Moreover, Belarus, Turkey and Sri Lanka have the status of Dialogue Partners. Although, Turkmenistan participates in some meetings, has no certain status.

The principal aims of the SCO are to strengthen the mutual confidence, friendship and neighborship between member states, to develop multi-profile of co-operation in order to keep along with maintaining peace, security and stability in the region. Moreover, it

[60] www.sectsco.org

encourages effective cooperation in politics and economy, trade, culture, education, tourism, environment fields as well as in transport and energy areas. Although this organization considered all these areas of interest until now it focused mainly on military and security issues.

Map 2.4: The Shanghai Cooperation Organization (SCO), 2001

*Source: Central Asia Research Group (*http://www.asiacentral.es/grupoub/mapas.php*)*

1.6. Conclusions

The objective of the chapter was to understand the integration decisions taken by Tajikistan and the more plausible future of its integration process. To achieve this objective, the chapter presented a survey of the integration process of Tajikistan, both from an economic and, in lesser extent, political perspective, by analyzing the different integration options followed by Tajikistan after independence.

Logically, the first strategic option was to sign agreements within ex-Soviet orbit. This also in its turn combined two strategies: agreements including the whole post-Soviet space and Central Asian regional agreements. At the same time, Tajikistan tried to insert itself into the global market by joining multilateral and global international organizations and financial institutions, being the most relevant the UN, IMF, WB, and WTO; this is what we consider the second option. There was also a third option, consisting in the

integration between Tajikistan and countries outside “Ex-Soviet” orbit and, in some cases, including also other ex-Soviet countries. Within this option we distinguish the insertion into the Islamic World and The New Regional platform in the context of a "peaceful rise of China".

The agreements within the post-Soviet space were the first option for integration projects not only for Tajikistan but almost for all Former Soviet Republics. This is usually referred to as "re-integration". The first agreement within this option was the Commonwealth of Independent States (CIS), signed in 1991, including the former Soviet republics with the exception of the three Baltic States (Estonia, Latvia and Lithuania) and Georgia.

In a broad context, the CIS was not a successful project. The majority of works analyzing the CIS agreement performance conclude that it was not taken seriously neither by the majority of its members nor by other countries, because it never had a clear purpose and even those who have had did never reach it (Freinkman et all, 2004; Pomfret, 2004; Tai and Lee, 2009; Dragneva and Wolczuk, 2013; Cooper, 2013; Kembayev, 2014). Also Putin (2011) claims that, in the first place, this refers to a hastily developed integration project, whose principal function was ensuring a civilized character of the post-Soviet "divorce" (Putin, 2007). However, from another side, he considers that the CIS has been an organization with a “generic” or “fundamental aspect” for any other integration agreements of the former Soviet Union.

In 1995, it was clear that in the near future the creation of a single “geopolitical space” encompassing the entire CIS was not possible due to fundamental disagreements between the member States over the purpose of their organization, (Kembayev, 2014). This action led to the division of this great alliance into different smaller integration groups. These initiatives tended to replicate the CIS model in a smaller format; something the development of the Eurasian Economic Community (EurAsEC) clearly illustrates (Dragneva and Wolczuk, 2012). In some way, the integration initiatives between the countries of Central Asia could also be considered as small groups of integration within the integration of ex-Soviet space or within the CIS alliance but they were originally a different strategy.

However, despite of the fact that main country challenges in Central Asian region have transboundary nature (water and energy, transport and the potential of Islamic

Resistance) which requires regional cooperation, both integration projects initiated by this region under the leadership of Kazakhstan (the Central Asian Economic Community, CAEC, stablished in 1994 and the Central Asian Cooperation Organization, CACO, stablished in 2002) have remained, in fact, on paper (Ushakova, 2003; Pomfret, 2004; Kembayev, 2009; Kuzmina, 2012; Laruelle and Peyrouse, 2013). The Central Asian states have not been able to establish even one regional integration organization, which would have formed a common strategy of the Central Asian countries, without the involvement of external actors (Laruelle and Peyrouse, 2013). This is caused by either a lack of political will (like neutrality immediately after independence in the case of Turkmenistan, and with Uzbekistan from the second half of 1990) or the absence of consensus on who should lead the integration initiatives (competition between Uzbekistan and Kazakhstan, and competition of Uzbekistan with Tajikistan and Kyrgyzstan) (Linn, 2012). This situation has weakened all the Central Asian states and made any common action impossible, allowing them to speak on more favorable conditions with outside factors, especially with Russia and China.

So, into the ex-Soviet area, the Eurasian Economic Community (EurAsEC) is the most successful and advanced union and it seems the integration project with more perspectives of future development, (Pomfret, 2004; Dragneva and Wolczuk, 2012; Kuzmina, 2012; Libman and Vinokurov, 2012; Cooper, 2013; Kembayev, 2014; Galiakberov and Abdullin, 2014; Yesdauletova, 2014).

Unlike other world experiences of regional economic integration like the European Union, NAFTA or Mercosur, this project is more in the nature of a re-integration perspective (Cooper, 2013). EurAsEC countries had a common past in the Soviet Union, with a shared economic system, common infrastructures in relation to energy, transport and communications and the same educational research and development systems. They also shared a common administrative language, Russian, and this is still to a large extent the case today. CIS also was a re-integrating project but in that case, they were new young states keen on preserving their newfound sovereignty, which explains the fail on getting deeper integration.

Thus, in principle, integration should be easier for these countries, and perhaps more rapid once initiated on an appropriate basis, than it was for the EU or Mercosur. However, there is an important political difference. Inevitably, Eurasian integration is

asymmetric, Russia being the dominant party in terms of territory, population, economic strength and military might. A Russian leadership, which can explain an important part of the current and expected success of EurAsEC in terms of the reintegration objective, can also have a negative impact on prospects for successful integration. Being the clearly dominant economy, there is also a danger that any negative shock in Russia will have spillover effects in the smaller economies of the region.

In the terms of the second option, that was referred to as the global market, it is evident the interest of Tajikistan in join international global organizations as a signal of nationhood (in the case of being a member of UN) or as potential financial support and assistance (as a member of the IMF and the World Bank). Moreover, the potential benefits of WTO membership for Tajikistan would be considerable, especially after WTO accession of China and Russia. These benefits will increase significantly after the accession to the WTO of other main partner countries such as Kazakhstan.

Finally, regarding the third integration option, also in the context of regional integration agreements but not just with ex-Soviet countries but including other countries or strictly with outsider countries, Tajikistan followed essentially two alternatives: the insertion in the Islamic world and the regional integration with China. In both cases, the objectives are more in terms of security issues, in a generic sense, than economic goals.

However, given the geo-strategic position of Tajikistan and after the terrible civil war, security issues have been predominant issues of economic development and, in fact, the proposals offered by external actors and international organizations are supported only if they are of interest in terms of internal problems. Some regional organizations are seen as representing a threat to the order of Tajikistan or Central Asia stabilization (Laruelle and Peyrouse, 2013). At this regard, he argues that, for example, Islamic organizations are perceived with antipathy, since these organizations tend to spread this kind of Islam that is understood as a potential political rival of the legitimacy of secular regimes; but also European organizations promoting democratic principles, because they are considered as a menace to the security conditions.

Furthermore, China's interest is to continue promoting the Shanghai Cooperation Organization (SCO) as its main multilateral and multi-polar forum for contacts with Central Asian countries, including Tajikistan and to promote bilateral relations with each country in the region. Chinese economic expansion in trade and investment does not

require the presence of a patron in the form of a regional organization, and even if Moscow succeeds with Eurasian Union, China will remain a key trading partner and investor in Tajikistan and in all Central Asia (Laruelle and Peyrouse, 2013).

Thus, once seen the negative and positive aspects of the different integration options followed by Tajikistan, we can conclude that integration way of this small country is being, in fact, complex and in any case to continue playing in such multiple integration fields would be difficult for this country. The country has to pay special attention to some of these integration projects for both economic reasons and politic ones. We can conclude that currently the most natural way for Tajikistan would be to continue the EurAsEC integration and this for two main reasons. As for the economic reason, the community of States does not need to create a common market from "scratch" because for many decades they have worked in the framework of a single economic complex. The second reason is a political one, as that the most military potency possesses only this project. This is, of course, the think of Putin (2011) but also the findings of researchers like Cooper (2013) or Laruelle and Peyrouse (2013). Although the EurAsEC project may not be the best option, it remains a better and a more natural and safe way than other options.

Chapter 3.

The Static Trade Effects of EurAsEC: the impact on Tajikistan trade

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Chapter 3
The Static Trade Effects of EurAsEC: the impact on Tajikistan trade

1.1. Introduction

In the first chapter we have provided a review of the theoretical literature on regional economic integration: causes (determinants) and consequences (potential effects). Although it is known that not only economic factors but also a number of political and geostrategic factors determine the desirability and the success of an economic integration agreement, especially in the case of developing countries, the potential economic effects which increase the welfare level of the members remain as the most relevant element in justifying the accession to an integrated area (Allen, 1963; Inotai, 1991; Grossman and Helpman, 1994; World Bank, 2000; Hosny, 2013; Marinov, 2014). So, focusing on potential economic effects, in spite of the relevance of dynamic effects, which influence the economic growth rate in medium and long terms, static trade effects (in terms of the theory of Viner-Meade-Lipsey) remain as essential determinants in the formation of integration agreements. In chapter two we have shown that among the several integration options followed by Tajikistan, the EurAsEC agreement stands as the currently most successful one and as the one with the greatest future, being the priority integration process of Tajikistan in the last years.

In the current chapter our interest will turn to the empirical identification of economic integration effects, in particular, the static trade effects of the EurAsEC agreement for the integrated area as a whole and for Tajikistan trade. At this regard, the balance between trade creation and trade diversion is one of the key elements determining the net welfare effects of a commercial preferential agreement. Trade creation occurs when high cost domestic production is substituted by low cost production from partners of the regional area while trade diversion occurs when low costs production from the rest of the world is substituted by high cost production from a regional partner.

The static trade effects of an economic integration agreement (in terms of trade creation and trade diversion) were analyzed by a large number of papers; either following the Computable General Equilibrium Models methodology (Deardorff, 1998; Brown et al, 2003; Robinson and Thierfelder, 2002, Piermartini and Teh, 2005; Hertel, 1997, 2006;

Baldwin and Venables, 1995) or by estimating a Gravity Model (Anderson, 1979; Bergstrand, 1985; Deardorff, 1998; Soloaga and Winters, 2001; Rose and van Wincoop (2000); Glick and Rose (2001); Anderson and van Wincoop, 2003; Wall, 2000, 2002, 2003; Dee and Gali, 2003 Bergstrand and Baier, 2007; Yang and Martínez-Zarzoso, 2013).

This chapter analyses the static trade effects of the EurAsEC agreement, in particular for Tajikistan. By estimating an augmented Gravity Model with panel data in which regional dummy variables are included, we analyze the impact of EurAsEC on bilateral imports and exports with main partner countries, focusing on trade creation and trade diversion effects. Testing the model for a sample of 26 countries over the period 1995-2013, we find that EurAsEC had a trade creation effect without evidence of a trade diversion effect. Moreover, trade creation effect within the EurAsEC area is larger than the trade creation effect with the rest of the considered partner countries. Moreover, the EurAsEC agreement had a positive impact on the Tajikistan trade.

After this introduction, the chapter is organized as follows. Section two provides a review of the empirical analysis of the effects of regional integration, taking into account the different approaches with special attention to Gravity Models. In the third section, we show a brief overview of the EurAsEC trade performance. Section four analyzes the trade creation and trade diversion effects of EurAsEC and the effects on Tajikistan trade by estimating with panel data an augmented gravity model. Finally, in section five, we present some conclusions.

1.2. Empirical analysis of the regional integration effects

In recent years, the empirical analysis on the effects of regional trade integration on economic outcomes has grown sharply. WTO (2005) has appropriately noted that these exercises in quantification have been made possible by advances in theory and in analytical techniques, and no less importantly, by the dramatically increased computational and data processing power of computers.

Undoubtedly, any debate of the effects of RTAs begins with Viner's (1950) seminal investigation in terms of trade creation and trade diversion effects. While a number of criteria have been put forward for evaluating the chances of trade creation and trade diversion in a union, it seems to be generally agreed that an a priori decision regarding the

net effect of customs unions on trade flows cannot be made, giving relevance to empirical studies of trade creation and trade diversion in a RIA.

In general, we may attempt to evaluate the possible effects in advance or after the union has been established (Balassa, 1967), that is, the analysis can be of an ex ante or an ex post character. In this regard, Grimwade et al., (2011) have reviewed some of the main methods used to measure the impact of regional integration, and distinguished four broad approaches to the empirical analysis of the effects of economic integration. They compare and contrast the different approaches, identifying in each case their major strengths and weaknesses. The considered methods are the following:

- The first and simplest approach is to construct an "*anti-monde*", showing what would have happened to trade flows in the absence of integration according to a set of clear hypotheses and to treat any difference between actual and predicted trade flows as being a measure of the integration effect. Such an approach is often referred to as the **"residual approach"**. A commonplace in such models is to assume that the changes would have been the same in the post-integration period as in the pre-integration one. This approach was widely used in the early days of post-war European integration to determine the ex-post effects of the formation of the European Economic Community (EEC). Although such approach has the attractiveness of great simplicity, there are many problems in predicting the path that trade would have taken had integration not happened.
- The second approach is an extension of the first. It consists of an attempt to formalize a model of the factors that determine some "natural" amount of bilateral trade taking place between any two countries, given their geographical features or the so- called **"intensity of trade"**. The major task is to find a suitable index for measuring trade intensity. In short, the intensity of trade approach measures the extent to which any two countries are economically integrated, although without distinguishing between market and institutional integration effects. Particularly, this issue related to policy changes leads academics to the third approach.
- The third method is largely an extension of the second and has come into renewed prominence over the last decade. It uses **stochastic econometric models** to estimate the impact of integration on trade. This, too, involves the construction of a model capable of explaining most of the factors that determine the amount of trade

one country does with another or the change in the level of this trade over time, including factors such as membership of the same regional trading block. The model is then applied to bilateral trade over the relevant period of time and the coefficients of the different variables are estimated. The most common model for this kind of exercise is the **gravity model** of trade.

- The fourth approach is to use a multicountry, static or dynamic **computable general equilibrium (CGE) model**. Such models seek to explain the main equilibrium relationships between the different sectors of the economy of each country and between the different countries themselves. Having done so, the model is simulated dynamically to analyze the extent to which different economic variables have been affected by the integration process. The difference between the actual and predicted levels of different variables measures the impact of economic integration. Therefore, CGE models are especially useful for measuring the effects of integration on economic growth. However, CGE models are not exempt of criticisms. In particular, some authors find such models as unduly abstract and divorced from reality because they describe a purely hypothetical situation of what will happen at some stage in the future with and without integration.[61] Even applied to the past they require strong assumptions.

Another methodology pursued in the literature in the analysis of the effects of regional integration on trade is a descriptive approach (Anderson and Norheim, 1993; Yeats, 1998). These works use several indicators to measure the regional concentration of trade. In the descriptive approach is assumed that the share of trade with the partner country would not have changed in absence of the preferential agreement. The approaches most commonly used in the empirical literature, especially in the most recent works, are the Computable general equilibrium (CGE) and the Gravity models. Next, we discuss these two widespread approaches for the the analysis of the effects of trade into the context of RTAs.

1.2.1. General Equilibrium Models

General Equilibrium Models (GEM) assume a certain model structure, with specific functional forms and are often used to predict the effects of a regional trade agreement

[61] See De Rosa, 1998 and Robinson and Thrierfelder, 2002 for a survey of studies based on CGE models,

(RTA) before it is formed. *Ex-ante* studies have used counterfactual analysis based on *partial* or *general equilibrium models* (GEM).[62] These models with a sufficiently tight theoretical structure can also be used to draw direct inferences about welfare. The model is then subjected to the preferential removal of tariffs alone, and the welfare effects are calculated (Dee and Galli, 2003).

In essence, CGE models are computer-based simulations, like laboratory experiments. They compute how today's economy will look in the future as a consequence of a specified set of policy changes. In the trade field, CGE models are used to estimate the trade and income effects of different liberalization scenarios. They identify the sources of income gains or losses from further opening up to trade and show how these are distributed among countries or regions.

The main benefit of CGE models is that they offer a rigorous and theoretically consistent framework for analyzing trade policy questions. The figures that come out of the simulations should only be used to give a sense of the order of magnitude that a change in policy can mean for economic welfare or trade. In order to create further confidence in the results the simulations should make use of sensitivity analysis (Piermartini and Teh, 2005).

Since the contributions of Meade (1955) and Lipsey (1957), General Equilibrium Models have played a relevant role in economic analysis. In the area of RTA there is a significant number of empirical works following this methodology (Deardorff, 1998; Brown et al, 2003; Robinson and Thierfelder, 2002, Piermartini and Teh, 2005; Hertel, 1997; Baldwin and Venables, 1995). These papers use the ex-ante CGE approach to analyse the impact of different trade agreements and investigate what effects can be expected from them. Robinson and Thierfelder, (2002) have used multi-country computable general equilibrium (CGE)[63] models to analyze potential and actual regional

[62] Economic analysis may be partial equilibrium or general equilibrium in nature. A general equilibrium analysis explicitly accounts for all the links between sectors of an economy - households, firms, governments and countries. A partial equilibrium model typically focuses only on one part (specific market) or sector of the economy, assuming that the impact of that sector on the rest of the economy and vice versa is either non-existent or small. It does not take into account the link between factor incomes and expenditures. Therefore, partial equilibrium models cannot be used to determine income, while general equilibrium models can. However, there are circumstances when the benefits of a general equilibrium model are offset by the high level of aggregation required to be able to use comparable and consistent data and by the difficulties in the specification of parameters and functional forms in the model (Piermartini and Teh, 2005).

[63] The theoretical models suggest that the net impact of an RTA on trade creation and trade diversion is ambiguous. It depends on the export capacity of the partner country and how the world price from the RTA partner compares to the world price from the least cost producer who is not an RTA member. An

trade agreements (RTAs) such as NAFTA, MERCOSUR, EFTA or EU. Their results indicate that these RTAs improve welfare, that trade creation greatly exceeds trade diversion, and that they are consistent with further global liberalization. They show that the welfare gains are greater when the models incorporate aspects of ‘‘new trade theory’’ such as increasing returns, imperfect competition, and links between trade liberalization, total factor productivity growth, and capital accumulation.

Baldwin and Venables, (1995) also used Computable equilibrium models and suggested that such methods have perhaps become the predominant research approach to assessing RIAs. According to these authors, GEMs have made two distinct contributions to the evaluation of RIAs. Firstly, they provide estimates of the effects of actual or proposed RIAs. However, since even the most sophisticated models cannot capture the full impact of complicated RIAs, the results give only a partial estimate of the true impact. Secondly, they have also helped to understand the theoretical interactions in models that are too complicated to study analytically. The studies of NAFTA and EC92 cases illustrate the wide range of possible effects that can be captured in such models and the range of predictions that can be generated. It is important to think of these models as playing two distinct roles; namely, policy analysis and "theory with numbers".

Dee and Gali (2003) discuss some examples in their study and note that CGE analyses suffer from a number of practical difficulties: some assume fixed terms of trade, which rules out one of the key effects of RTAs, namely, terms of trade changes. In addition, these studies typically ignore many of the non-tariff measures and provisions affecting non-merchandise trade.

However, they conclude that when used with appropriate assumptions CGE can give valuable insights into the possible effects of tariff provision of RTAs. Further, Hosny (2013) provides a recent summary of the literature on Computable General Equilibrium (CGE) trade models by analyzing the effects of trade policy changes. He concluded that CGE models have numerous advantages and are a powerful tool for analyzing the effects of trade policy changes. Nevertheless, although the use of CGE’s is widely accepted, this

RTA can be net trade-creating in one sector and net trade diverting in another sector. To determine the implications of an RTA for aggregate welfare and trade patterns, one needs economy wide, multi-sectoral, computable general equilibrium (CGE) models. Further, multi-country CGE models differ widely in terms of country and commodity coverage, assumed market structure, policy detail, and specification of macroeconomic closure (Robenson and Thierfelder 2002).

doesn't imply that the CGE type of analysis is not without limitations as showed by Dee and Gali (2003). Therefore, conclusions drawn from surveys of CGE studies should be treated cautiously.

Piermartini and Teh, (2005) in their clear explanation of CGE and gravity models have stressed that models differ in the type of analysis they conduct regarding how a change in trade policy affects the initial equilibrium of the economy, i.e., its initial state before the policy is introduced. In a comparative static approach, one examines how a change in policy changes the endogenous variables.

The concern is with the difference between the initial and final equilibrium of the economy and not with the transition required to move from the initial equilibrium to the final one. One limitation of this approach is that it may fail to capture some of the costs and benefits associated with the transition and therefore overstate or understate the benefits from the change in trade policy. All the costs associated with this re-allocation of resources would not be included in a comparative static analysis.

In contrast to the *ex-ante* approach, *ex-post* studies of RTAs do not estimate welfare effects directly, they measure trade creation and trade diversion effects by using econometric techniques to establish a link between actual RTA formation and actual trade outcomes, controlling for the effects of all other influences, (Dee and Galli, 2003).

Following the view of Dee and Galli, for the evaluation of static trade effects (trade creation and trade diversion), the present work will use an ex-post estimation, i.e., an econometric approach based on the Gravity model. Furthermore, Dee and Galli (2003) suggest that the gravity model is the key ex post econometric technique for the analysis of the determinants of bilateral trade flows and effects of RTAs.

1.2.2. The Gravity model

1.2.2.1. Theoretical underpinnings and development

The Gravity model is a widely used econometric technique on international trade, and has been applied in a large number of empirical researches. Its name originally comes from the similarity to the Newtonian "Law of Universal Gravitation": the force of gravity between two bodies is positively related to the mass of the attracting items and negatively to the square of the distance between them.

Related with this, the gravity model on international trade predicts that the volume of trade between two countries will be positively related to the size of their economies (their GDP) and negatively related to the distance (transportation costs) between them.

The roots of this approach can be found in the early paper of Tinbergen (1962) who suggested that approximately the same functional form of the traditional gravity equation could be used in evaluating international trade flows: the volume of trade as a growing function of the national incomes of the participating countries. The basic equation is given as:

$$\boldsymbol{X_{ij}} = \boldsymbol{A}\frac{\boldsymbol{Y_i Y_j}}{\boldsymbol{D_{ij}}} \ , \qquad (1)$$

where

A is a constant

X_{ij} is the value of exports (or trade flows) from country i to j;

Y_i is the GDP of country i and Y_j is the GDP of country j;

D_{ij} represents the geographical distance between the two countries.

Tinberger (1962) tried to determine the "normal pattern" of international trade in the absence of "discriminatory trade impediments" (such as the Commonwealth or the BENELUX) and to estimate the effect of such agreements (Bergstrand and Egger, 2011). Later, many other works, our work among them, had the same motivation for using the gravity equation.

Since its emergence, this model became a very actively used tool in empirical studies, most commonly specified as equation (1), and a large body of empirical literature has emerged, see *inter alia* Linnemann, 1966; Balassa, 1967; Aitken, 1973; Anderson, 1979; Bergstrand, 1985; 1989; Deardorff, 1998; Soloaga and Winters, 2001; Rose and van Wincoop, 2001; Glick and Rose, 2001; Wall, 2000, 2001, 2003; Anderson and van Wincoop, 2003; Bergstrand and Baier, 2007; Yang and Martínez-Zarzoso, 2013. This literature has made significant contribution on the theoretical and empirical foundation of the gravity model.

Nevertheless, even though this model became prominent due to its perceived empirical success, at the same time it has been criticized due to its lack of a consistent

theoretical foundation[64]. Therefore, the gravity model has been regarded as a weak approach to the analysis of trade flows by some academics, who suggest that estimated coefficients are not reliable given the aforementioned problems.

The first attempts to provide a theoretical rationale to the gravity model is Anderson (1979), who was the first to present a formal theoretical foundation for the gravity model[65]. This model was built under constant elasticity of substitution (CES) preferences, and assumed that products are differentiated by country of origin and that consumers have preferences defined over all the differentiated products. In other words, this is the so called *Armington assumption*. This first theoretical background for the gravity model was subsequently developed by the works of Bergstrand (1985), Helpman and Krugman (1985), Deardorff (1998) and Anderson and van Wincoop, 2003.

Further, the absence of price terms in Anderson's model motivated the development of the monopolistic competition model of Bergstrand (1985), who investigated the theoretical determination of bilateral intra-industry trade in a series of papers. Bergstrand presented this model as a reduced form of the general equilibrium model of international trade, and following Anderson's (1979) assumptions he considered CES preferences over Armington-differentiated goods and added price indexes. He found that price indexes, besides to the traditional gravity variables, were also statistically significant. Bergstrand (1989) and Helpman (1987) depart from the Armington assumption and consider the Dixit-Stiglitz (1977) monopolistic competition model, focusing their attention on product differentiation among firms rather than among countries. Piermartini and Teh (2005) point that Bergstrand models with monopolistic competition overcome the undesirable feature of Armington models, where goods are differentiated by location and production by assumption. The firm location is endogenously determined and countries are specialized in the production of different sets of goods.

[64] The good fit and relatively tight clustering of coefficient estimates in the vast empirical literature suggested that some underlying economic law must be at work, but in the absence of an accepted connection to economic theory, most economists ignored gravity models (Anderson, 2011). According to Bergstrand and Egger (2011), prior to 1979 the absence of rigorous theoretical microeconomic foundations for the gravity equation in international trade inhibited its use for policy work and left the equation on the periphery of mainstream international trade research.

[65] The Andderson`s model is based upon three assumptions. First, he assumes that each country specializes completely in the production of its own good, and there is one good for each country produced exogenously (i.e., an "endowment economy"). Second, he assumes identical, homothetic preferences. Third, he also assumes a frictionless world with zero transport costs, tariffs, and distribution costs; with no frictions, all prices can be normalized to unity (Bergstrand and Egger, 2011).

Deardorff (1998) derived the gravity model for the value of bilateral trade following Anderson (1979) in the use of market clearance from extreme cases of the Heckscher-Ohlin structure. Deardorff's framework was in fact very similar to what Anderson (1979) had examined in his work. This author tries to find whether a gravity model works in a neoclassical world with impeded trade, although Deardorf motivated the differentiation among products by the HO model's case to explain specialization rather than by the Armington assumption. Anderson modeled preferences over only traded goods, while Deardorff assumed for simplicity that they hold over all goods. Anderson's primary concern was to examine the econometric properties of the resulting equations, rather than to extract easily interpretable theoretical implications as tried to find Deardorff.

Anderson and Wincoop (2003) showed that indeed, gravity equations were not theoretically grounded, although they had a very good fit to the data and estimates were sensible. This implies both that the econometric estimations suffered from the omitted variable bias and that comparative statics analysis was unfounded. Moreover, the models generally suffered of a lack of understanding of what was driving the results. According to these authors, the theoretically appropriate average trade barrier refers to the "multilateral resistance." In order to conduct a comparative statics exercise, such as asking what the effects of removing certain trade barriers are, one has to be able to solve the general-equilibrium model before and after the removal of such trade barriers. From this point of view, they developed a method that consistently and efficiently estimated a theoretical gravity equation (using a system of equations to allow for the endogeneity of prices in estimation) and correctly calculated the comparative statics of trade frictions.

Consequently, their basic gravity model significantly simplifies the expressions derived by Anderson (1979) and Deardorff (1998).

$$x_{ij} = \frac{Y_i \; Y_J}{Y^w} \left(\frac{t_{ij}}{P_i \, P_j} \right)^{1-0} \qquad (3)$$

In this equation, they refer to the price indices (P_i) as "multilateral resistance" variables as they depend on all bilateral resistances (tj), including those not directly involving (i). A rise in trade barriers with all trading partners will raise the index. It should be noted that (Yw) represents world's GDP. Moreover, they implemented the theory both

in the context of a two-country model, consisting of the United States and Canada, and a in a multi-country model that also included other industrialized countries.

In the light of above discussion, they suggested an alternative to the estimation method consisting of the replacement of the multilateral resistance terms with country-specific dummies. This leads to consistent estimates of model parameters. The main advantage is simplicity as the use of ordinary least squares (OLS) estimation is feasible. Another advantage is that there is no need to make any assumptions about internal distances to states and provinces, which are needed to compute the structural multilateral resistance terms and are difficult to measure. Rose and van Wincoop (2000) and Glick and Rose (2001) have used this estimator when applying the method in their papers to determine the effect on trade of monetary unions. In any case, Anderson and Winccop (2003,) conclude that *"the key aspect of the gravity model, the dependence of trade on bilateral and multilateral resistance will hold up under a wide range of generalizations"*.

In general, existing literature indicates that, far from being a purely econometric approach without a theoretical foundation, the gravity model is a valid tool to analyse bilateral trade flows. Following Anderson (1979) these studies have preserved the CES preference structure and have presented the gravity model as a reduced form of the GEM of international trade in goods. In addition, they showed that, on the one hand, gravity models in a simple form can be derived out just from the trade theories (Ricardian Approach, Heckscher-Ohlin structure to explain specialization and Helpman-Krugman Approach of monopolistic competition). On the other hand, they have also taken into account the two main determinants that characterize the models of the new theory of trade: economies of scale combined with differentiated products and transportation costs, which ultimately provide a theoretical justification of the gravity model.

The above discussion shows that there exists a theoretical foundation underlying the use of gravity models for the anlaysis of international trade flows. Once more, the empirical success of the revised literature, departing from Anderson (1979), Bergstrand (1985), Deardorrf (1998) and Anderson and Wincoop (2003) stimulates our concern for evaluating regional trade flows by using the gravity model in the present work.

1.2.2.2. Theoretical linkages of explanatory variables

In gravity models, a number of variables are generally used to capture trade costs. For example, distance and dummies for island, landlocked and common borders are used to reflect the hypotheses that transport costs increase with distance, they are higher for landlocked countries and islands, but are lower for neighbouring countries. Dummies for common language, adjacency or other relevant cultural features, such as colonial history, are used to capture information costs. Search costs are probably lower in trade between countries whose business practices, competitiveness and delivery reliability are well known to one another. Tariff barriers are generally included in the form of dummies for the existence of regional trade agreements (Piermartini and Teh, 2005).

According to Sologoa and Winters (2001), the gravity variables of the model (GDP, population, distance, exchange rate, cultural similarities) control for those factors that are assumed to explain "*normal"* trade between countries. Thus, in the absence of a preferential trade agreement (PTA), members' trade would have the same relationship to the gravity variables as the other countries in the sample. In this setting, the block-related dummy variables capture *"abnormal"* levels of trade that could be attributed to a PTA.

The large number of studies using the gravity equation starting by Aitken (1973), have identified the importance of RTAs-specific dummy variables for the identification of the impact of the RTAs in the participating countries, especially in estimating static trade creation and trade diversion effects. While Anderson (1979), Bergstrand (1985 and 1989), Helpman and Krugman (1985), Deardorf (1998), Anderson and Wincoop (2003) made their contribution to the gravity model departing from the rigorous theoretical foundation and explanations for the log linear form, others as Linnemann (1966)[66], Aitken (1973), Frankel (1997), Frankel and Wei (1995), Limao and Venables (2001) Soloaga and Winters (2001) developed a methodology to identify the explanatory variables specification and the supplement of new variables to the model.

In the context of capturing trade effects of RTAs, the first who added a dummy variable, was Aitken (1973). He introduced such type of dummy aiming to evaluate the effect of trade creation and trade diversion. Later, Bayoumi and Eichengreen (1995), Frankel (1997) and Frankel and Wei (1998); have included a second set of dummy

[66] Linnemann (1966) augmented the gravity model by adding the coefficient of population variable to capture economies of scale and used the GNP as an independent variable for the propensity to import.

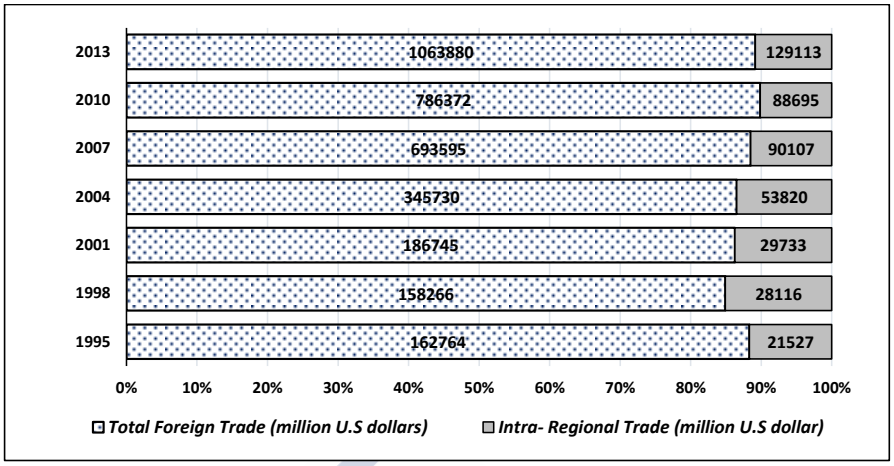
variables for each PTA to capture the separate effects on intra-bloc and extra-bloc trade. They used such dummies for testing the effects of membership in a common regional grouping. Sologoa and Winter (2001) have augmented the gravity model by adding a third set of dummy variables. Their main goal was to explore the effects of regional arrangements on the members' internal and external trade flows in terms of Viner's trade creation and trade diversion. Moreover, their concern was to reduce uncertainty about the latter effects proxying for omitted variables. They modify the usual gravity equation to identify the separate effects of PTAs on intra-bloc trade, members' total imports, and members' total exports by defining three sets of dummy variables for each trade block.

1.3. The EurAsEC trade performance: A brief overview

Since 1995 the trade volume of EurAsEC had an increasing tendency, which was intensified after 2001, with the exception of 2009, which like for the rest of the world was characterized by a general reduction in the volume of trade due to the global crisis. In spite of the area's trade was multiplied by 6.5 between 1995 and 2013, the percentage of intra-regional trade has not increased over the average; by the contrary, the participation of intra-regional trade in total trade of the region has decreased slightly (from 12% to 11% of total trade) (Graph 3.1).

So, in terms of the contribution of the economic integration process on intra-regional trade, on one hand, one could say that the Eurasian Economic Community is not a successful commercial agreement, since the share of intraregional trade on total trade does not increase. But, on the other hand, intra-regional trade increased over the period. Then, what we can interpret as trade creation within the area and also trade creation with the rest of the world (no trade diversion) should be interpreted as a positive result. The existence of trade creation and trade diversion effects of EurAsEC, once many other explanatory variables are considered, is what we determine in the next section.

Graph 3.1. Total foreign trade and intra-regional trade turnover of EurAzEC



Source: Own elaboration from UNCTAD DATA

The intra-regional trade within EurAsEC is distinguished by some particular characteristics which explain the poorer dynamic of intra-regional trade. First, a high reliance on one country market (Russia and to a lesser extent Kazakhstan), which makes the members of the regional association very vulnerable to the economic situation prevailing in Russia. So that, despite the extra-regional orientation of trade of the EurAsEC countries, Russia remains as the principal trading partner for almost all members of the Community. Belarus and Kazakhstan represent the second and third position respectively. Although the weight of Russia fell in recent years, by 2013 it still represented 45% of total EurAsEC trade. Tajikistan's participation has been declining over the period, accounting only 1.1% in 2013. The second characteristic is the prevalence of traditional products (with low added value) and the absence of significant changes in the structure of the comparative advantage. Third, EurAsEC trade is also characterized for its high export commodity concentration, especially in the trade with the rest of the world and for the reduction of intra-industry trade, as well as the intensity and the complementarity of trade (Tochitskaya et al, 2008). Finally, a fundamental challenge related to the little relevance of trade within this region is transport cost (Kuzmina, 2012).

1.4. Trade creation and trade diversion effects of EurAsEC: Trade effects in Tajikistan

1.4.1. The Gravity model in the context of the present study. Why a Gravity Model?

As stated earlier, gravity models have been widely used to evaluate the effects of regional integration agreements (RIAs) –particularly, free trade agreements (FTAs), customs unions (trade creation/trade diversion), trade patterns (the impact of trade policies on trade flows) and other forms of preferential trade agreements (PTAs).

The gravity equation has been one of the most successful empirical models in economics, ordering remarkably well the enormous observed variation in economic interaction across space in both trade and factor movements. It has been widely used to infer trade flow effects of institutions such as customs unions, exchange-rate mechanisms, ethnic ties, language differences, and international borders and so on, Anderson (2011). Moreover, econometric evaluations have an advantage in that they can be appraised by standard statistical criteria and such approaches have evaluated the effects of RTAs on a wide range of variables, Baldwin and Venables (1995).

According to the World Trade Organization (2005), there are two main reasons for the central role played by the gravity model in empirical work on international trade. The first has to do with the high explanatory value of the model in explaining bilateral trade flows. This ability to provide accurate representations of trade flows is related to the fact that the gravity model has the distinguishing feature of integrating the weight of the geographical, linguistic, historical and cultural similarity in bilateral trade between the two trading partners. The second reason is that these models provide an easy method to estimate the impact of other variables in the trade process.

In the light of the above discussion we consider that the econometric gravity model is very appropriate for assessing the trade effects (trade creation and trade diversion) of the economic integration agreement Eurasian Economic Community (EurAsEC) as a whole and, in particular, in the case of Tajikistan.

1.4.2. Specification of the model and variable selection

In this section, we estimate a gravity model for the EurAsEC countries in order to disentangle two main questions. Our first aim is to assess whether the agreement has implied increased trade among bloc members. We should expect that the existence of such an agreement should foster trade between members, which can be measured either through total imports, total exports or total trade (imports + exports) from other members of the agreement. There is, however, a second important question related to the first one, specifically whether this increased trade has implied also increased trade with the rest of the world (ROW), i.e., if the reduction of barriers to trade has fostered also trade with other trade partners, or alternatively, whether this agreement actually reduces trade with the rest of the world. The former case would be identified with trade creation, whereas the latter would be identified with trade diversion.

There are some important issues to deal with before we begin with our econometric exercise. The first one is related to the **sample of countries to be included** in the analysis. The obvious approach is to include the five members of the EurAsEC agreement. However, restricting our analysis to these five countries would limit the scope of the study, since we would only be able to observe trade flows between these countries and therefore the identification of trade creation or trade diversion from the rest of the world would not be possible. Therefore, we need to increase the sample of countries to be included. These additional countries should share some similarities in order to correctly asses the effects of the agreement. In origin (before the agreement was signed) these countries should share some economic, social or political linkages, so that we can compare how trade has evolved in the countries that form the trade area (between each other and with the rest of the world partners) and in those countries that chose not to join. Our approach has been to construct a panel of 10 countries, all of them former members of the Commonwealth of Independent States (CIS), which is the origin of the EurAsEC agreement. This provides a natural ground to assess the trade effects of the agreement. Thus, we gather data from Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine. Note that in this panel, 5 members belong to the EurAsEC and 5 members do not.

A second issue is related to the **sequence of our analysis**. We are interested in the effects of the agreement for the countries that formed the EurAsEC area in general, and for

Tajikistan in particular. Therefore, our analysis will follow this structure, determining first the effects for the whole area, and then for Tajikistan. Also, we will provide several specifications of the gravity equation, in order to check for robustness of the econometric results.

As we have already seen, the existing gravity model literature gives several indications as regards the factors that affect trade direction. Indeed, the literature has showed that in this model trade flows between two countries are explained, in the first place, by their economic size, measured through GDP (income), and geographical distance (transaction costs). Both are core-determining variables of trade capacity in gravity model (Balassa, 1967; De Rosa, 2007). Nevertheless, the model is augmented with further several variables, which could either facilitate or dampen trade flows. Among these variables we may point GDP per capita, population, real exchange rate and so on. Other variables, which have been included in some models as a result of the particular countries under study, try to control for geographic impact and historical ties, as dummy variables for common language, landlocked, colonial, contiguity, trade policy (RTA) and others.

Our study follows the methodology applied previously in the literature (see inter alia Zidi and Dhifalla, 2013 or Akoete, 2008) and augments the basic formulation of the gravity model with variables representing factors that could either facilitate or impede trade. We will use the value of imports and the value of exports as the dependent variables, using as explanatory variables GDP (coded as GDP), population (POP), distance (DIST), the real exchange rate (RER), dummies for contiguity (CONT), common speak language (COMLANG), landlocked (LAND) and adjacency by USSR (USSR) and, in order to verify the impact of the regional agreement on bilateral trade, we include two "regional" dummy variables (imports from (exports to) EurAsEC members, MT_{EurAs}, and imports from (exports to) non-members of EurAsEC, MT_{ROW}). The equation we will estimate, in its logarithmic form, taking imports as the dependent variable, is given by:[67]

$$Ln\, M_{ijt} = \beta_0 + \beta_1 Ln\, GDP_{it} + \beta_2 Ln\, GDP_{jt} + \beta_3 Ln\, POP_{it} + \beta_4 Ln\, POP_{jt} + \beta_5 Ln\, DIST_{ij} + \beta_6 Ln\, RER_{ijt} + \beta_7 CONT_{ij} + \beta_8 COMspLANG_{ij} + \beta_9 COMnatLANG_{ij} + \beta_{10} USSR_j + \beta_{11} LANDLOCK_{ij} + \beta_{12} MT_{EurAs} + \beta_{13} MT_{ROW} + U_{ijt} \qquad (4)$$

[67] We also estimate the same equation taking exports as the dependent variable.

Were the form of the error term u_{ijt} will be discussed below.

Because of the multiplicative nature of the gravity equation, it is common practice to use its log-linear form. In practice, the gravity equation relates the natural logarithm of the monetary value of trade between two countries to the log of their respective GDPs, a composite term measuring barriers and incentives to trade between them, and terms measuring barriers to trade between each of them and the rest of the world. This specification allows in addition an easy interpretation of the estimated parameters: the parameters of an equation estimated in logarithms are elasticities. For example, the estimated parameter for the GDP in a gravity equation estimated in logarithms is the elasticity of trade to GDP, indicating the percentage variation in trade following a 1 per cent increase in GDP (UNCDAT, 2012).

The definitions of each of the included variables are provided next:

$\boldsymbol{Ln\ M_{ijt}}$ is bilateral imports of a country i from a country j in year t; measured in million US dollars. Several works take total trade as dependent variable, but using as the dependent variable the value of exports or imports is better because it allows estimating different income elasticities for exports and imports (Frankel and Wei, 1998). Moreover, Cernat (2001) showed that for a given pair of countries, the use of total bilateral trade does not allow distinguishing between the impacts of RTA formation on exports from a non-member to RTA members from that on exports from an RTA member to a non-member. He argues that a constant level for overall bilateral trade (exports and imports) might be the result of a reduction in imports from non-members and an increase in exports from RTA-members to third countries. Further, Akoete (2008) suggests that the use of imports value as a dependent variable is better when flows are studied from the country of arrival perspective, because countries tend to monitor their imports more accurately than their exports, given that taxes are levied on the former.

In Tajikistan, from 2000 to 2013 exports increased in average just 1.8% per year (from 748.9 million to 1141.9 millions), but imports boomed 4.4 times that figure (from 688.1 million to 4139.4). Therefore, it is interesting to analyse separately the effect on imports and on exports. So, we also take as dependent variable the value of bilateral exports of country I from country j, $\boldsymbol{Ln\ X_{ijt}}$.

$\boldsymbol{Ln\ GDP_{it}}$ *and* $\boldsymbol{Ln\ GDP_{jt}}$ are the GDP of the country *i* and country *j*, respectively (measured in million US dollars). GDP, a variable indicative of the size of the economy, is

a powerful predictor of trade potential. This variable should have a positive impact on trade flows in both directions. This means that GDP growth in an importing country will increase economic capacity which in turn, will boost imports. Likewise, GDP growth of an exporting country induces richness and competitiveness. Related to this, Frankel and Kahler (1993) suggest that real GDP is included to capture the factors associated with the level of economic development, as well as the productive capacity of the exporting country and the purchasing power of the importing country.

$\boldsymbol{Ln\ POP_{it}}$ *and* $\boldsymbol{Ln\ POP_{jt}}$ are the size of the population of countries i and j respectively. On the one hand, a larger population promotes large market size and economies of scale, and should therefore lead to a positive sign for its impact on trade. However, on the other hand, a large domestic market with rich resource endowments can imply a large internal absorption effect, which could restrain bilateral trade; in this case this variable can have a negative impact on trade flows.

$\boldsymbol{Ln\ DIST_{ij}}$ is the geographical distance between capital cities of the country *i* and country *j*, measured in thousands of miles. Distance variable has a significant impact on trade flows, mainly when one of the trade partners is a landlocked. Tinbergen (1962) already suggested that the volume of trade could be evaluated as a growing significant function of the GDP of the trading countries and a decreasing function of the distance between them. Since this variable represents a restriction or friction to trade we expect the distance coefficient to be negative. However, there are other various factors which influence the trade flows even more than physical distance. Worse access to the market, delivery time requirements, transport costs and other distance factors related costs tend to reduce the volume of trade.

$\boldsymbol{Ln\ RER_{ijt}}$ is the real bilateral exchange rate between country *i* and country *j* in year *t*. The exchange rate allows to capturing the evolution of competitiveness (Soloaga and Winters, 2001). Following Bergstrand (1985), the majority of studies using a gravity model include the real exchange rate (RER) because this variable includes the impact of trading member's prices. An increase in this variable, reflecting a real currency depreciation of the importing country (i) with respect to the exporting country (j), leads to a decrease of imports of country (i) from country (j). Thus, the expected sign of this variable is negative.

We compute the RER from the nominal exchange rate of each country vis-à-vis the U.S. dollar and the consumer price index for each countries (CPI) in every year from 1995 to 2013. Following previous contributions (Akoete, 2008; Zidi and Miloud, 2013) we compute the RER by the following formula:

$$RER_{\frac{countryi}{partnerj}} = \left(\frac{CPI_{partnerj}}{CPI_{countryi}}\right)_t \times \left(\frac{NER_{\frac{countryi}{\$}}}{NER_{\frac{partnerj}{\$}}}\right)_t$$

To control for economic, political, geographical, cultural and historical influences on the direction of trade, we have included some dummy variables. Dummy variables commonly used in order to identify factors of resistance or promotion of trade are: Common speak language, Common Border, Landlocked, etc. Usually such dummies are defined as variables facilitating trade and therefore their expected sign should be positive. In our empirical model we include[68]:

$\boldsymbol{CONT_{ij}}$ is the dummy variable for common border between country *i* and country *j*, which takes value 1 if the countries share a common border and 0 otherwise.

$\boldsymbol{COMspLANG_{ij}}$ is the probability (0-1) that a random pair of people from the two countries understand one another in some language[69].

$\boldsymbol{COMnatLANG_{ij}}$ is the probability (0-1) that a random pair of people from the two countries speak the same native language.

In this regard, based on the CEPII-language data, (CSL and CNL: percentage of population by at least 4% of the population in two countries[70]), and following the thorough work of Melitz and Toubal (2012), we try to estimate separately the impact of these two language aspects on bilateral trade, in order to understand whether the linguistic influences come from ethnicity and trust or from ease of communication. If CSL is significant in the presence of CNL, the significance of CSL would clearly reflect ease of communication rather than ethnicity and trust.

[68] Even though we present a list of potential dummy variables, only those statistically significant will be kept in the analysis. Appendix B summarises the estimation of the full model, with all of these dummy variables included in the regression. As can be seen, only a limited subset of these variables is significant, and therefore included in our final baseline model.

[69] The usual measure of a common language is a binary zero - one, based on official status. However, it is not obvious that such a measure of a common language can adequately reflect the diverse sources of linguistic influence on trade, including ethnic ties and trust, ability to communicate directly, and ability to communicate indirectly through interpreters and translation (Melitz and Toubal, 2012).

[70] See: http://www.cepii.fr/CEPII/en/bdd_modele/presentation.asp?id=19

The findings of Melitz and Toubal (2012) have shown that the impact of linguistic factors, all together, is at least twice as great as the usual dummy variable for a common language, resting on official language.

$\boldsymbol{LANDLOCK_{ij}}$ is the dummy variable for landlocked, taking value 1 if partner country is landlocked, and 0 otherwise.

$\boldsymbol{USSR_j}$ is a dummy variable that takes value 1 if the partners have been members of the Former Soviet Union, and 0 otherwise.

In principle, being former Soviet Union (USSR) members is a facilitating factor for trade since these economies had closer economic relation before independence and certainly they still have some common ways of doing things in addition to a common speaking language to a greater or lesser extent.

Because we are interested in capturing the impact of regional trade agreements, regional dummy variables between country *i* and country *j* are key in our model. We introduce two specific dummy variables for EurAsEC agreement:

$\boldsymbol{MT_{EurAs}}$ takes value 1 if both countries are members of the EurAsEC bloc at time t, and 0 otherwise.

$\boldsymbol{MT_{ROW}}$ takes value 1 if the importing country is member of the EurAsEC bloc and the exporting country *j* is not a member, and therefore is part of the ROW at time *t*, and 0 otherwise.

According to UNCTAD (2012) a positive (and significant) coefficient on both variables is suggestive of trade creation; a positive on the first but negative on the second one is suggestive of trade diversion.

1.4.3. The Sample of countries and Data Source

In order to achieve relevant empirical results, the availability of an appropriate and reliable dataset is crucial, especially when the researcher analyses small and undeveloped countries, which often do not have relevant economic data available. It has been generally recognized in empirical work the absence of good quality data for some countries, especially with sectorial breakdown data and a relatively large time dimension (World Trade Organization, 2005). Missing data, measurements errors and sample selection bias can be the source of differences in estimation. Some of these problems arise from the data

sources themselves. For example, bilateral trade data fail to distinguish between zero trade and missing data.

The existing literature has proven that the best approach to the estimation of a gravity model is through the use of panel-data, in order to balance the cross section dimension (number of included countries in the estimation) and the time dimension that, as noted previously, is not always long enough as to perform single-country econometric analysis. On the other hand, especially in terms of trade, data scarcity and the importance of trading membership do not allow us to choose any countries. Moreover, time dimension is another issue. For instance, in our case, initially we wanted to use a sample from 1991 (year of the independence of CIS countries) to use as much statistical information as possible. However, we could not follow this strategy because of missing data before 1995 for most of the countries included in the sample. Therefore, the selection of partner countries to be included in this study has followed several requirements: First, availability of data. Second, the relevance as trading partners. For each of the reporter countries, selected partners account by above 60% of total imports and exports. For instance, in 2000, imports from the 25 partner countries account from 60% for Armenia to 92% for Tajikistan; in 2013, from 67% for Armenia and Russia to 89% for Tajikistan and 86% for Belarus and Kazakhstan.

Thus, in the light of the above discussion we estimate our model with annual data for a panel that covers bilateral import flows for the 10 CIS reporter countries with 25 partner countries included in the sample, for the period from 1995 to 2013. Each cross-section unit in the panel is identified as a bilateral relationship between each of the 10 reporter countries and the remaining 25 trading partners, i.e., an import flow from each of the 25 partner countries towards one of the 10 reporter countries. Therefore, the cross-section dimension of the panel comprises 250 units. The group of 26 trading partners includes, besides Tajikistan, 10 countries from the CIS; 10 from the EU and 5 others main trade neighbour partner countries like China, Turkey, Iran, Afghanistan and Pakistan. The full list of the selected countries is given in the (Appendix 1).

Given the type of variables included in our gravity model, we have gathered our data from different sources. Nevertheless, the majority of the data has been taken from the datasets provided by the World Bank, WTO, UNCTAD, and the French database CEPII. We consider all of these datasets reliable sources since they have been widely used in the

empirical literature. We have also taken some additional data from several National Statistical databases. Table 1 below summarises the data sources for each of the variables included in the model.

Table 3.1. Data sources

Brief Description	Dataset
Bilateral import and export values from Trade Data: Import and export data are mainly taken from UNCTAD. Some missing UNCTAD data are replaced by the remaining datasets	- World Integrated Trade Solution (WITS) – the World Bank. http://wits.worldbank.org/ - United Nations Conference on Trade and Development-UNCTAD. www.unctad.org - Agency on Statistics under President of the Republic of Tajikistan. www.stat.tj -National Statistical Organization. http://www.unece.org/stats/links.html
Data on GDP, Index of consumer price (ICP), Population and Exchange Rate	- World Bank Data (WDI, 2013); World Development Indicators (WDI) database http://data.worldbank.org/datacatalog/world-development-indicators/wdi-2013. -International Monetary Fund-IFM, www.ifm.org;
Data on the Regional Integration Agreements	-The Regional Trade Agreements Information System (RTA-IS) – the World Trade Organization (WTO) http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx
Data on Distance, Languages, Landlocked: In order to calculate the distance between countries, we have generally used the index called "distwces" and "diskm" (between their capitals and economic cities).	CEPIIDatabase http://www.cepii.fr/cepii/en/bdd_modele/bdd.asp

1.4.4. Econometric methodology

Before discussing our econometric results, it is important to summarise the empirical methodology, as well as to discuss the estimation technique. Following the discussion in Matyas (1997), the correct econometric representation of the gravity model takes the form of a triple-indexed model:

$$lnM_{ijt} = \alpha_i + \gamma_j + \lambda_t + \beta_1 lnY_{it} + \beta_2 lnY_{jt} + \beta_3 lndist_{ij} + \cdots + u_{ijt}$$

where M is the volume of imports of country i from country j at time t, Y_{it} is the GDP in country i at time t, Y_{jt} is the GDP of country j at time t, $dist_{ij}$ is the distance between countries i and j, $i=1,\ldots,N$, $j=1,\ldots,i-1,i+1,\ldots,N+1$, $t=1,\ldots,T$; α_i is a home country effect, γ_j is the target country effect, λ_t is the time effect (business cycle), and u_{ijt} is a white noise disturbance term. This representation is a simplified version of a standard

gravity model, where we have only included two variables measuring "mass" (GDP) and one variable measuring distance, but this equation can be easily augmented to include further determinants of trade, as suggested by theory. In this regards, this representation should be regarded as an explanatory tool.

There are two major issues discussed in the literature with respect to this equation. First, whether α, γ and λ should be modelled as **random or fixed effects**. Second, whether this specification allows for the inclusion of **regional dummy variables** to test the hypothesis that trading blocs have a significant role in the explanation of trade. We will start with this last issue, and leave the discussion about fixed vs random effects aside for a while.

Matyas, (1997) shows that, assuming the effects are fixed, the above model is a generic form of any gravity model, and a generalisation of the two-way fixed effects panel data model. If a cross-section data set is used (Aitken, 1973, Bergstrand, 1985, Frankel *et al*, 1995), *T=1* and an additional restriction is imposed, namely$\lambda = 0$. If, alternatively, time series data is used, then *N=1* and the restriction $\alpha = 0$ is imposed. When panel data is used, none of these restrictions are imposed. Matyas (1997) shows that if regional dummies are included in the model to take into account the effects of bloc trade, failing to account simultaneously for local, target and time effects leads to a misspecification of the model, and therefore to biased estimations. Therefore, he suggests that any estimation of the gravity model with regional dummy variables should be augmented with such type of effects. This result is confirmed by Egger and Pfaffermayr (2003), who show that the Matyas model is only a restricted version of a general counterpart which also includes bilateral interaction effects. They apply this general model to a panel of 11 APEC countries, and test the restriction that these interaction effects are jointly zero, which is firmly rejected. Bayoumi and Eichengreen, (1997), Cheng (1999), Wall (2002, 2003) and Coughlin and Wall (2003) reach similar conclusions, while Glick and Rose (2001) and Pakko and Wall (2001) use the gravity model augmented with all of these effects to analyse the trade effects of currency unions.

Once it is generally accepted that these type of gravity models should include local, target and time effects, the discussion can move forward as how to model these effects, i.e., whether they should be modelled as random or fixed. Egger (2000) discusses the pros and cons of such models. He points that the fixed effects specification is preferred due to two

main reasons. First, fixed effects are introduced to control for unobserved heterogeneity among trading partners, which can be related to tariff policies, environmental variables, size of country, access to transnational infrastructure networks, geographical and historical determinants, etc. All of these effects are clearly non random, and should therefore be captured by a fixed effect. Secondly, when the gravity model is applied to a specific set of countries, with the objective of projecting trade flows between the areas under study, the selection of countries involved in the analysis is not random (i.e., countries included in the sample are not randomly drawn) but are ex ante fixed. Therefore, the best option should be a fixed effects model. Cheng and Wall (2005) reinforce this idea, and show that if country heterogeneity is not accounted for correctly, gravity models tend to overestimate the effects of integration on the volume of trade. Glick and Rose (2001), Pakko and Wall (2001), Wall (2000), Millimet and Osang (2004) or Egger (2002) use gravity models with fixed effects to study trade effects of different contexts, such as currency unions, trade potentials, etc.

Therefore, in this analysis, and following previous literature we opt for a fixed effect version of the gravity equation (4). This equation is estimated by OLS, including a home country, a partner country and a period fixed effect.

Before performing any regression we must take into account the dynamic properties of the variables in the panel, namely whether they are panel-stationary or not. This is important, because if variables were not stationary and residuals from the estimation are indeed stationary, equation (4) could be interpreted as a cointegrating relationship, and a panel-VECM model should be estimated in order to correctly identify the long and short run elasticities of the different variables. However, if the panel is stationary, we can rely on standard panel-data techniques, and estimate equation (4) as a stationary long run relationship. Therefore, we perform **panel unit root tests** to the variables in the model.

The literature on panel unit rots has grown rapidly during the recent years. The aim of the majority of contributions has been to provide reliable tests to identify the presence of unit roots in the panel variables of the econometric models. Among all of the tests that have been suggested in the literature we rely on the Maddala-Wu test (Maddala and Wu, 1999), which is an exact nonparametric test based on Fisher (1932). The test statistic is given by:

$$\lambda = -2\sum_{i=1}^{N} \ln p_i \sim \chi^2\,(2N)$$

where p_i is the probability value of the Augmented Dickey Fuller test for the i-th unit (country). Since it combines the significance of N different independent unit roots statistics, the Fisher test has a number of interesting advantages, which we summarise next:

- The autoregressive parameter is not restricted to be homogeneous across countries under the alternative of stationarity.
- The lag length and the inclusion of a time trend in the individual ADF equations are determined separately for each country, taking into account, thus, for potential specific development in individual country data.
- The sample sizes of the individual ADF test can differ according to data availability for each cross-sectional unit.
- The test can be used with any type of unit root test for the individual units.

Following the usual practice in the literature we have opted for the ADF test in these individual regressions, but have checked that results are similar with other unit root tests. Results of the Maddala-Wu test are summarised in table 2, which provides the value of the test statistic and the associated p-value. Note that the null is the existence of a unit root in the panel variable, and therefore low values of the p-value would allow to reject the null of unit root.

Table 3.2: Panel unit root tests

	Fisher's λ	**p-value**
Ln Mijt	1063.45	0.00
Ln Xijt	1198.46	0.00
Ln GDPit	863.73	0.00
Ln GDPjt	1279.74	0.00
Ln GPDPCit	727.85	0.00
ln GDPPCjt	885.34	0.00
Ln Popit	588.36	0.00
Ln Popjt	600.59	0.00
Ln RERijt	2062.04	0.00

Our results suggest that all of the variables included in the panel are stationary, given that the values of the test-statistic are well above the 5% critical value of a $\chi^2(500)$, which is 553.12, and therefore we can confidently proceed with stationary panel econometric techniques without risking obtaining spurious relationships between the involved variables in the model.

1.4.5. Results

Estimation of different specifications of equation (4) are summarised in tables 3 and 4. Specifically, table 3 summarises the estimates when the dependent variable is total imports, while as a consistency check, we have also run the estimations using the exports as the dependent variable. These results are summarised in table 4. As discussed previously, in each of these estimations we include a fixed effect for each home and trade partner country, as well as a time fixed effect.

We start by column (1) in table 3, which describes the point estimates for the standard baseline model, in which imports are regressed on GDP (both in the home country and in the exporting country), total population in the home and exporting country, the real exchange rate, the distance, and dummies controlling for contiguity, common speak language and common native language. We observe that both GDP's coefficients are highly significant, with a positive value of 0.742 for the home country and of -0.141 for the partner's GDP. Population in the home country is not significant, while the population in the exporting country is negative and significant at the 10% level. The real exchange rate is not significant, while distance shows a significant negative coefficient of -0.966, and contiguity and sharing the language have a significant and expected positive coefficient.

Overall, the model seems to fit well with the gravity model assumptions, but the low value of the Durbin-Watson statistic suggests signs of serial correlation. We then re-estimate the model including the first lag of imports to control for such correlation. Results are summarised in column (2). The inertia in imports is remarkable, with an autoregresive coefficient of 0.714. Home GDP shows now a coefficient of 0.268 while partner's GDP has a coefficient of -0.148, which imply long run elasticities of 0.93 and -0.51 respectively.[71] Population is again not significant, both in the home and in the exporting

[71] For a estimated dynamic model of the type

country, suggesting that this variable plays no role in the explanation of trading flows in the area under study. The real exchange rate is marginally significant at the 12% level, with a coefficient of -0.014 and a corresponding long run elasticity of -0.05. Finally, distance is also significant with a negative coefficient of -0.190 (long run impact of 0.66), contiguity has a significant coefficient of 0.210 (long run impact of 0.734) and both variables controlling for common language are significant: the common speaking language has a short run coefficient of 0.195 and a long run elasticity of 0.68; while common native language has a coefficient of 0.243 and a long run elasticity of 0.84.

Thus, these preliminary results suggest that the gravity model captures well the bilateral trade flows (measured through imports) between the 10 CIS countries included in the sample as reporter countries and the corresponding 25 trade partners. The fact that population has no role in the explanation of trade flows within the area forces us to drop both variables from the model and re-estimate the equation. Results are summarised in column (3). Essentially, results are maintained, and all of the estimated coefficients are significant at standard levels. Home GDP has a coefficient of 0.269 and a long run elasticity of 0.94; partner's GDP shows a coefficient of -0.157 (long run elasticity of -0.55); the real exchange rate is now significant at the 10% level (short and long run elasticities of -0.015 and -0.05 respectively). The remaining variables have virtually the same estimated coefficients as in column (2), with slight differences in the long run elasticities. In sum, the model described in column (3) is a standard gravity model, with expected signs on the included variables and a reasonable goodness of fit (R^2 and Adjusted R^2 of 92% and 91% respectively). We therefore rely on this specification to analyse the impact of EurAsEC on the volume of trade through the inclusion of two regional dummies: one to control for bloc trade (MTEurAs) and another one to control for trade with the rest of the world (MTRow).

$$y_t = \hat{\beta}_0 + \hat{\beta}_1 y_{t-1} + \hat{\beta}_2 x_t$$

the long run solution can be derived under the assumption that the dynamic variable *y* stabilises in its steady state value, given the long run values of the exogenous variable *x*, i.e.

$$y_t = y_{t-1} = y_{ss}$$

and therefore

$$y_{ss} = \frac{\hat{\beta}_0}{1-\hat{\beta}} + \frac{\hat{\beta}_2}{1-\hat{\beta}} x_{LR}$$

Therefore, while the short run elasticity of *y* with respect to *x* is (assuming the variables are in logs) $\hat{\beta}_2$, the long run elasticity is given by $\frac{\hat{\beta}_2}{1-\hat{\beta}}$.

We have started with an augmented specification, in which all of the dummy variables described above were included, and checked for significance. Only those dummies that became significant were kept in the estimations.[72] In this process we found that the Common Native Language variable became not significant, and has been consequently dropped. Therefore, we estimate the gravity model, including one lag of imports, to account for serial correlation, and including all of these dummies, as well as the local, target and time fixed effects. Results are summarised in column (4) of table 3.

All of the coefficients are significant at the 5% level, and all of the signs are as expected. Coefficients for lagged imports, home GDP and partner's GDP are similar to those obtained in previous specifications. Thus, home GDP has a local impact of 0.275 on imports, and a long run elasticity of 0.95, while partner's GDP has a short run elasticity of -0.157 and a long run elasticity of -0.55. The real exchange rate impacts negatively on imports, with a long run elasticity of -0.06, and the distance between the two trading partners also is negatively related to imports (short run impact of -0.208 and long run effect of -0.72). The contiguity dummy has an expected positive coefficient of 0.203, which implies that the long run effect of sharing a common border is 0.70). The Common Speaking Language variable has a positive coefficient of 0.163, with a long run elasticity of 0.56). Turning now to the analysis of the regional dummies, the MTEurAs variable identifies the impact of this trade agreement on the volume of trade among members. This effect is unambiguously positive and significant, with a point estimate of 0.586. Once we allow for the dynamics of imports to be settled, the long run impact is 2.04, which implies that the effect of the agreement on imports is an increase of 670% with respect to the trend.[73] This obviously indicates that the effects of this agreement have been powerful and that the result has been a large increase in the level of trade among members.

The dummy MTRow allows identifying whether this increase in trade has taken place by a substitution of imports from the rest of the world towards the other members of the agreement, or if on the contrary, the agreement has also fostered imports from the rest of the world. The positive and significant coefficient of the dummy indicates that the latter

[72] In each case, the deletion of the variable from the model was tested with a standard Wald test, whose null hypothesis could not be rejected.

[73] To compute the elasticity of imports with respect to these regional dummies we use the approximation $e_{IMP/D} = e^{\hat{\beta}} - 1$, where $e_{IMP/D}$ is the elasticity of imports with respect to the dummy variable D, and $\hat{\beta}$ is the corresponding estimated long run impact of the variable.

has been the result, with a short run impact of 0.359, and a long run impact of 1.25, which implies that in the long run, trade with the rest of the world is 249% larger than in the absence of the agreement. These results, therefore, allow asserting that the EurAsEC agreement has been a source of trade creation in the area.

Two further questions remain open: first, what are the specific effects of the agreement for Tajikistan? Has Tajik's foreign trade been boosted after the agreement or not? Secondly, do these results hold if we consider exports as the dependent variable instead of imports?

Table 3.3. Summary of Estimation Results (Case 1: Intra-EurAsEC bilateral imports as dependent variable)

	EurAsEC								**Tajikistan**	
	(1)		**(2)**		**(3)**		**(4)**		**(5)**	
	Coef.	*p-value*	*Coef.*	*p-value*	*Coef.*	*p-value*	*Coef.*	*p-value*	*Coef.*	*p-value*
Ln Mijt-1			0.714	0.00	0.715	0.00	0.713	0.00	0.911	0.00
			(26.31)		(26.55)		(26.14)		(50.91)	
Ln GDPit	0.742	0.00	0.268	0.00	0.269	0.00	0.275	0.00	0.068	0.04
	(6.37)		(5.65)		(5.81)		(5.87)		(2.03)	
Ln GDPjt	-0.141	0.07	-0.148	0.03	-0.157	0.02	-0.157	0.02	0.012	0.56
	(-1.80)		(-2.08)		(-2.26)		(-2.27)		(0.58)	
Ln Popit	-0.906	0.20	0.027	0.91						
	(-1.26)		(0.10)							
Ln Popjt	-1.60	0.06	-0.464	0.17						
	(-1.83)		(-1.36)							
Ln RERijt	-0.031	0.29	-0.014	0.12	-0.015	0.09	-0.0179	0.04	0.032	0.00
	(-1.04)		(-1.55)		(-1.67)		(-1.98)		(2.63)	
Ln Distij	-0.701	0.00	-0.190	0.00	-0.188	0.00	-0.208	0.00	-0.033	0.56
	(-7.28)		(-5.40)		(-5.35)		(-5-84)		(-0.569)	
Contij	0.668	0.00	0.210	0.00	0.210	0.00	0.203	0.00	0.095	0.52
	(3.87)		(3.77)		(3.79)		(3.87)		(0.628)	
ComSpLangij	0.770	0.00	0.195	0.02	0.193	0.02	0.163	0.04	0.946	0.00
	(2.84)		(2.27)		(2.25)		(1.96)		(2.92)	
ComNatLangij	0.820	0.00	0.243	0.01	0.238	0.01				
	(2.83)		(2.46)		(2.45)					
MTEurAs							0.586	0.00	0.272	0.01
							(4.11)		(2.37)	
MTRow							0.359	0.00		
							(3.22)			
R2	0.80		0.92		0.92		0.92		0.90	
R2 Adjusted	0.80		0.91		0.91		0.91		0.90	
DW	0.49									
NxT	4412		4239		4139		4139		450	

To answer the first question, we construct a simplified sample of our dataset, including only bilateral trade in which one of the trading partners is Tajikistan. Then, we re-estimate the gravity model, including the corresponding regional dummies, except the MTRow variable, to avoid perfect collinearity: given that we are analysing only one country, which is a member of the EurAsEC, we can investigate whether the agreement increases trade or not with the remaining countries of the bloc, but necessarily, by construction, the remaining trading partners must be part of the rest of the world. Therefore, the MTEurAs and the MTRow portray the same information, and cannot be included in the same regression simultaneously. The results of the estimation of the gravity equation for Tajikistan are reported in column (5) of table 3. Results are in general worse than those obtained for the whole sample. The degree of inertia in Tajik's imports is even greater than for the whole CIS group (autoregressive coefficient of 0.911), and for the rest of the explanatory variables, only home GDP is significant, with a point estimate of 0.068 (long run elasticity of 0.76). Partner's GDP, distance and contiguity are now not significant, and the real exchange rate has a positive and significant coefficient of 0.032. Interestingly, the impact of EurAsEC is positive with a short run coefficient of 0.272, a long run impact of 3.05. Therefore, we can assert that this agreement has also boosted foreign trade for Tajikistan.

Table 4 summarises the econometric results for the model considering exports as the dependent variable. In general, the conclusions drawn from the imports model are maintained. Firstly, columns (1), (2) and (3) show that the gravity model expressed in terms of total exports seems to describe accurately the bilateral trade flows of the 10 reporter countries,[74] being the main variables significant, except the real exchange rate, whose coefficient is not significant in any of the three specifications. Therefore, exports (as a proxy of trade) are positively related to GDP in the home and in the target country, while distance is negatively related to export flows. Contiguity and a common speaking or native language also foster export flows.

[74] Column (1) is the standard baseline model with no dynamics, while column (2) controls for serial correlation adding a lagged term for the endogenous variable. Finally, column (3) drops population in the home and target countries given the non significance of these variables in the estimation summarised in column (2).

Table 3.4. Summary of Estimation Results (Case 2: Intra-EurAsEC bilateral exports as dependent variable)

	EurAsEC								Tajikistan	
	(1)		(2)		(3)		(4)		(5)	
	Coef.	*p-value*	*Coef.*	*p-value*	*Coef.*	*p-value*	*Coef.*	*p-value*	*Coef.*	*p-value*
Ln Xijt-1			0.777	0.00	0.777	0.00	0.778	0.00	0.824	0.00
			(40.55)		(41.54)		(41.70)		(23.52)	
Ln GDPit	0.793	0.00	0.254	0.00	0.253	0.00	0.250	0.00	-0.045	0.39
	(8.17)		(8.73)		(10.69)		(10.67)		(-0.84)	
Ln GDPjt	0.136	0.14	0.076	0.03	0.077	0.02	0.076	0.02	0.091	0.00
	(1.46)		(2.13)		(2.19)		(2.17)		(3.37)	
Ln Popit	0.458	0.00	-0.002	0.95						
	(3.04)		(-0.05)							
Ln Popjt	1.774	0.03	0.075	0.78						
	(2.16)		(0.272)							
Ln RERijt	0.039	0.08	0.004	0.47	0.004	0.43	0.005	0.37	0.008	0.59
	(1.74)		(0.722)		(0.77)		(0.89)		(0.53)	
Ln Distij	-0.686	0.00	-0.158	0.00	-0.159	0.00	-0.174	0.00	-0.097	0.03
	(-6.09)		(-5.32)		(-5.53)		(-6.09)		(-2.10)	
Contij	0.616	0.01	0.109	0.10	0.108	0.09	0.103	0.12	0.133	0.08
	(2.57)		(1.63)		(1.64)		(1.54)		(1.73)	
ComSpLangij	0.980	0.00	0.245	0.00	0.246	0.00	0.190	0.00	1.235	0.00
	(3.60)		(3.47)		(3.49)		(2.69)		(4.71)	
ComNatLangij	0.631	0.02	0.189	0.00	0.188	0.01				
	(2.19)		(2.58)		(2.54)					
MTEurAs							0.199	0.00	0.308	0.00
							(2.77)		(3.32)	
MTRow							0.027	0.51		
							(0.65)			
R2	0.72		0.89		0.89		0.89		0.80	
R2 Adjusted	0.72		0.89		0.89		0.89		0.79	
DW	0.41									
NxT	4419		4142		4142		4142		450	

Column (4) summarises the results for the augmented model with regional dummies. In this case we find that exports are positively related to home and partner's GDP's and negatively to the distance between countries, being all of these coefficients significant. Interestingly, the coefficient on contiguity (even though marginally significant)

is positive (as expected), with a short run impact of 0.103 and a long run effect of 0.46, while the common speaking language has a coefficient of 0.190, with a long run impact of 0.85. The MTEurAs dummy has a positive coefficient of 0.199, with a long run impact of 0.89, which implies an increased trade of 145%, a weaker than that obtained in the imports model. This increase in exports is followed by increased exports to the rest of the world, since the coefficient on the dummy MTRow is positive, even though rather small (0.027), which implies a long run effect of 0.121 and an increased trade of 13%. Also, as in the case of imports, the model for Tajikistan is rather poor, since few of the variables are significant (only partner's GDP, distance and the common speaking language). In this case, sharing a common border is positive for Tajik's exports, while the impact of the EurAsEC agreement is estimated to be greater than for the whole bloc, with a short run coefficient of 0.308, a long run impact of 1.75, which implies that exports are 475% greater with respect to trend.

1.5. Conclusions

Regional trade agreements are trade policies that try to encourage trade between members and with the rest of the world. Estimating an augmented gravity model, this chapter analyzed the effects of EurAsEC for bilateral trade of member countries and for trade of these countries with the rest of their main partners. As a particular case, the chapter also analyses the impact of the EurAsEC agreement on Tajikistan trade flows.

From the results we can say that the gravity model explains well intra-regional trade in the case of EurAsEC. In general, the traditional variables of the gravity model explaining the "normal" trade are significant and have the expected signs. Results show that intra-regional trade flows between EurAsEC members are positively related to GDP of the reporter country (as importer or as exporter) and variables representing aspects facilitating trade like share a common border or a language, and negatively related to distance. Partner's country GDP has a positive effect on intra-regional exports but a negative effect on intra-regional imports. Real exchange rate has the expected negative effect on intra-EurAsEC imports and for intra-regional exports the sign of the coefficient is positive but this variable is not significant.

With regard to the effects of the preferential agreement, the coefficients of the regional dummy variables show unambiguously that EurAsEC generated a net trade

creation effect. Membership in EurAsEC had significant effects on bilateral trade within the area, mainly in terms of imports, without generate trade diversion from the rest of the world. Imports from and exports to the no-EurAsEC partners also were positively affected but to a lesser extent than intra-regional flows.

Results for Tajikistan trade flows show that imports are positively related to Tajikistan's GDP and exports are positively related to partner countries GDP. Sharing a language positively affects both imports and exports. Moreover, exports are positively affected by sharing a border and negatively affected by distance; however, both variables are not significant in explaining imports. Membership of EurAsEC positively affects Tajikistan trade flows, to a much larger extent on imports than on exports but in both cases to a larger extent than on total EurAsEC trade flows.

We can conclude that EurAsEC had a positive net trade creation effect and, therefore, a positive welfare effect. So, moving towards greater integration degrees seems a good recommendation to achieve the objective of increasing trade flows and welfare of the members.

Tajikistan imports greatly increased after the entry into EurAsEC, both from the area and from other partners outside the area. However, exports have showed a very poor performance, generating a huge trade deficit. Nevertheless, the export performance has not been so bad with EurAsEC partners than with some of the non-member which were traditionally important partners, namely the European Union. Therefore, in the context of EurAsEC, intensifying relations with member countries and reducing costs of transporting goods to these countries seem to be good recommendations. But Tajikistan should not concentrate its commercial policy efforts only on these partners. There are more dynamic neighboring economies outside EurAsEC, namely Turkey and China, which also should be stated objectives for the Tajikistan exports.

Appendix 1

Table 3. A1. List of Reporter and Partner countries

Code_Partner	Patner_Country	Full-name
1	AFG	Afghanistan
2	ARM	Armenia
3	AUT	Austria
4	AZE	Azerbaijan
5	BEL	Belgium
6	BLR	Belarus
7	CHI	China
8	CZE	Czech Republic
9	DEU	Germany
10	FRA	Francia
11	GBR	United Kingdom
12	IRN	Iran
13	ITA	Italy
14	KAZ	Kazakhstan
15	KGZ	Kyrgyzstan
16	LTU	Lithuania
17	MDA	Moldavia
18	NLD	Netherlands
19	PAK	Pakistan
20	POL	Poland
21	RUS	Russia
22	TKM	Turkmenistan
23	TUR	Turkey
24	UKR	Ukraine
25	UZB	Uzbekistan
26	TJK	Tajikistan

Appendix B

Table 3.A2. Estimation of the full model. OLS with local, target and time fixed effects

	Imports		Exports	
	(1)		(2)	
	Coef.	p-value	Coef.	p-value
Ln GDPit	0.742	0.00	1.151	0.00
	(2.01)		(7.33)	
Ln GDPjt	-0.142	0.07	0.114	0.18
	(-1.81)		(1.32)	
Ln Popit	-0.904	0.20	-3.554	0.00
	(-1.25)		(-4.36)	
Ln Popjt	-1.604	0.06	1.929	0.01
	(-1.83)		(2.37)	
Ln RERijt	-0.031	0.28	-0.013	0.56
	(-1.05)		(-0.57)	
Ln Distij	-0.699	0.00	-0.655	0.00
	(-7.25)		(-5.66)	
Contij	0.667	0.00	0.677	0.00
	(3.87)		(3.04)	
ComSpLangij	0.752	0.00	1.008	0.00
	(2.74)		(3.56)	
ComNatLangij	0.852	0.00	0.187	0.56
	(2.86)		(0.581)	
Landi	0.321	0.29	-0.891	0.18
	(1.03)		(-1.35)	
USSRj	0.696	0.56	2.89	0.10
	(0.583)		(1.62)	
R2	0.80		0.74	
R2 Adjusted	0.80		0.74	
DW	0.49		0.44	
NxT	4412		4419	

Chapter 4.

Dynamic effects of EurAsEC integration agreement for Tajikistan

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Chapter 4

Dynamic effects of EurAsEC integration agreement for Tajikistan

1.1. Introduction

Among the several integration options followed by Tajikistan over the past two decades (as it was showed in chapter two), it seems that in recent years it is giving priority to integration in EurAsEC, which has recently moved towards a greater degree of integration by forming an Economic Union of three member countries (Russia, Belarus and Kazakhstan). In the eve of Tajikistan' accession into the EurAsEC-Customs Union, the relevance of potential effects from integration for Tajikistan became a more decisive issue, especially in view of the existing political and economic backwardness.

Tajikistan, a small landlocked country with a geostrategic mountainous terrain, relative remoteness and communication isolation from the existing global transport infrastructure as well as numerous other transition challenges, confronted immediately after independence in 1991 a terrible civil war. This brought to the poorest country of the Former Soviet-Union to a deeper level of poverty, vandalism, and low pace of development in human capital and, of course, damaged infrastructure. Ensuring that regional economic integration succeeds in Tajikistan is vital, not only because of the previously mentioned challenges but also because of the policies that could ensure successful integration for a country that together with its neighbors has many elements of transboundary nature (water and energy, transport and the potential of Islamic Resistance) which inevitably require an "integrated" answer.

Chapter three has shown that the welfare effects of the EurAsEC agreement through static trade creation and trade diversion effects (in the context of the *Traditional Theory of Economic Integration*) are positive for Tajikistan although of a moderate amount. As it was seen in chapter one, the *New Theory Economic Integration* claims that the most important effects of integration processes are dynamic effects in terms of large-scale economies, technological change, effects on market structure and competition, productivity growth and investment activity. In essence, dynamic effects of economic integration are defined as anything that affects the country's rate of economic growth over the medium term, (Schiff and Winters, 1998, p. 179). Although the dynamic effects are the most relevant, mainly for

developing countries, the literature of economic integration dealing with developing and least developed countries, as it is the case for Tajikistan, has generally recognized that for such type of countries neither the “New” nor, mainly, the “traditional" economic integration theory are adequate. So, in the frame of the new economic integration theory, an extensive literature focus on the potential effects of integration to developing countries and the motivation of these countries to participate in integration processes beyond the static and dynamic effects, (Meier, 1960; Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al, 1969; Abdel Jaber, 1971; Robson, 1980; Mackay, 1984; De Melo, 2011; Hosny, 2013; Marinov, 2014).

At this regard, regional integration in Tajikistan is essential, expecting that it will help in enhancing development of not only because the static effects of resource allocation (as the traditional theory claims) but also enhanced economic growth and development objectives through creation of common projects such as poverty alleviation, improving standard and quality of life by promoting health and education issues, productive employment, services and coordination of foreign policy aiming at peace and security within and between the regions.

Thus, this chapter analyzes, on the one hand, the **dynamic effects** of EurAsEC for economic growth of Tajikistan and, on the other hand, also in the context of the New Regionalism, some of the **welfare effects of integration for developing countries** that are not covered by traditional analysis for developed countries, as well as some of the **factors motivating developing countries to participate in an integration area** that could give rationality to integration of Tajikistan into EurAsEC at both the current degree and perhaps a deeper degree in the future. Following Marinov (2014), the potential effects and factors which are relevant for developing countries, constituting the economic determinants of integration that influence the motivation of these countries to participate in integration agreements are organized into three categories: general economic (development objective), market-related, and trade-related determinants. In addition to economic determinants, there are also several political incentives of economic integration that are of special importance to developing countries.

In the context of **dynamic effects**, economic integration by attracting foreign direct investment (FDI) may affect aggregate productivity in the economy through technology transfer and increased competition and, then, positively affect the economic growth rate.

In Tajikistan, FDI has been dominated by investors such as Russia, China, Iran, Kazakhstan, and International financial organizations like the World Bank. The vast priority areas of FDI opportunities are directed, firstly, to the hydroelectric power, mining sector (primary aluminum) and agriculture development, especially, deep processing of cotton fibers and, secondly, to the banking sector, service industry, tourism and manufacture of construction materials. But, the lack of a national strategy for FDI promotion and transparent investment policies hinders the capacity of Tajik government to attract foreign investment (EDB, 2013; FAO, 2014; UNCDAT, 2014; State Statistical Agency of Tajikistan and Investment Committee of Tajikistan). According to the Bureau of economic and business affairs (2012), Tajikistan looks mostly after state-led investment and external loans from the country's perceived geopolitical friends rather than making conditions favorable to private investors from abroad.

Thus, Tajikistan, in line with most of the EurAsEC countries, showed a faster GDP growth averagely 7-8% between 1995 and 2013. However, despite the relatively stable macroeconomic indicators, Tajikistan's economy remains dependent on external factors which are a major source of vulnerability (World Bank, 2011). Two external factors deserve particular attention: the contribution of remittances (mainly from Russia) to Tajikistan's growth since 2004 (50% of GDP in 2013) and the fact that economic growth was mostly supported by development assistance from multilateral and bilateral development partners.

The economic growth of Tajikistan is very similar to EurAsEC countries, but country's GDP per capita is still significantly below all the EurAsEC members (GDP per capita in Tajikistan was only 7.2% of that of Russia in 2013) and nearly 35 percent population still lives under the absolute poverty line.

In spite of weak static and dynamic traditional effects, as a developing country, there are several economic and political determinants which can give rationality to the decision of Tajikistan join EurAsEC.

Among the economic determinants to integration, beyond the traditional static and dynamic effects, one of the most relevant for developing countries is the **economic development objective**. Poverty reduction was one of the fundamental and primary development objectives of Tajik government. After a period of political imbalance and gradually recuperation, the economy of Tajikistan has showed rapid growth that helped to

significantly decline the level of poverty that fell from over 80 percent to about 32 percent during the period 1999-2014. Remittances played a crucial role on poverty reduction, especially in rural areas (Azevedo et al, 2014). Nevertheless, despite high poverty alleviation, Tajikistan is still one of the poorest countries in the region in terms of per capita income.

The situation was similar in terms of other development indicators. In the beginning of the 90s, Tajikistan along with most of the post-Soviet countries had relatively high Human Development Index, reflecting the heritage of economic and social development achieved during the Soviet empire. However, with the disintegration result and civil war, its HDI has fallen sharply from 0.629 in 1991 to 0.535 in 2000. The decline in the HDI during this time indicates that the relative position of life expectancy, education and GDP per capita in Tajikistan has been deteriorated. Although recent dates show that Tajikistan's HDI value again increased up 0.624, putting the country in the medium category ranking (129 out of 188 countries), country's HDI is still behind the other EurAsEC countries, (UNDP, 2015).

Among the market-related determinants, of particular importance are the potential effects on **employment and productivity** and the **industry development** induced by integration. Tajikistan was unable to create enough jobs for a growing population and the unemployment rate remains the highest in the region. The jobs created are mainly in agriculture, which accounts for over 66% of total employment. Although productivity in the agricultural sector has increased in recent years, it remains far below that of other countries in the region. The answer to unemployment and poverty, especially in rural areas and by young people, has been migration. Tajik migrants abroad (mainly in Russia) are equivalent to 18% of country population. Consequently, remittances from migrant grown enormously since 2000, amounted to 45% country's GDP in 2013. Migrant remittances were a main driver of economic growth and development, with a positive effect on poverty alleviation and unemployment reduction, but the high dependence of Tajikistan on remittances from migrants (90% of them in Russia) and the effect of remittances on exchange rate are also a source of macroeconomic vulnerability.

Regarding the development of the industrial sector, the success of the integration process is highly doubtful, it is an outdated and deteriorated sector with low productivity. The participation of the industry has fallen from 39.3% to 21.8% of total GDP and from

9.9% to 4.1% of total employment, mainly due to the recent fall in cotton and aluminum prices (World Bank, 2011).

After showing the evolution of the trade trends and the trade structure (by sectors and partners) of Tajikistan, we present the evidence found on several **trade-related determinants** which are relevant in the case of developing countries, namely, trade as a percentage of GDP, trade pattern with developed countries, intra-regional trade and total regional trade and competitive versus complementarity countries.

The foreign trade turnover of Tajikistan has generally increased in the period 1995-2013. According to UNCTAD data, over the period exports have increased 1.5 times, while imports grew 5.1 times. From 2000 to 2013 imports boom (mainly after 2002) while exports show a very poor dynamic and negative trade balance becomes higher and higher. The percentage of GDP that is exported decrease dramatically after 2000 and the export coefficient falls from 91% to 13% over the period. Imports as a percentage of GDP accounted by 75% in 2000 and, in spite of the high GDP growth rates over the period, they accounted by 49% of GDP in 2013. Remittances (accounting by above 50% of GDP in 2013) explain this huge increase in imports.

In the context of EurAsEC, Tajikistan exports and imports represents a very small proportion, showing both variables a different evolution from 2000 to 2013. Imports evolution was in line with the rest of the countries keeping its participation in total EurAsEC imports by around 1.1%. By contrary, exports evolution was much less dynamic than for the rest of the countries so that its participation falls from 0.64% in 2000 to 0.18% in 2013.

The high concentration of Tajikistan exports in unwrought aluminum and cotton, which accounts for two-thirds of total exports, makes the Republic largely dependent on shocks like world prices. Imports are less concentrated than exports and, by contrary to exports, the concentration decreases over the period, showing a concentration index in 2013 very similar to Russia or Kazakhstan. The main partners of Tajikistan in recent years are China, Turkey and EurAsEC members (with which the dynamics of foreign trade turnover of Tajikistan with in the recent years had a positive trend); and EU and the CIS countries which are not members in EurAsEC (with which trade decreased with).

The increase of **the share of intra-regional** trade to total trade and the **increase of total trade** are common accepted indicators of integration agreement successful, although

Inotai (1991) shows that these indicators should not be the only ones considered in analyzing integration successful when integration takes place between developing countries. In the case of Tajikistan, the share of intra-EurAsEC trade in total foreign trade is higher than for the total area but the increase in trade with EurAsEC after joining the agreement was not greater than for total trade, so that the share of intra-regional trade decreases from 27% in 2001 to 25.5% in 2013

Trade as a percentage of GDP and **trade pattern with developed countries** are not relevant integration determinants in the case of Tajikistan explaining its desirability to enjoy EurAsEC beyond traditional static and dynamic effects. On the one hand, by 2000 Tajikistan was a highly open economy and the openness degree decrease from 2000 to 2013. On the other hand, trade flows of Tajikistan with the developed European countries has not increased over the period and the greater proportion of imported goods, consisting in consumer goods, are imported mainly from China.

Trade **complementarity indexes** show that the increasingly diversified basket of imports of Tajikistan increasingly fits the export structure of its partners. By the contrary, the export structure of the country fits less with the import structure of all the main partners, since exports basket of Tajikistan includes very few goods. Taking into account the qualitative information given by the TC index, by 2000 could reasonably be expected an expansion of trade after a preferential agreement with EurAsEC countries since the highest TC index values were shown for EurAsEC countries. However, from the index values in 2013, the relevance of a deeper integration agreement with EurAsEC countries is not as clear, especially in regarding TC index for imports.

After the introduction, the rest of this chapter is organized as follows. Section two will give an overview of Tajikistan. Section three focuses on the dynamic effects for the economic growth rate of Tajikistan into the context of EurAsEC. Section four analyses the potential dynamic effects of EurAsEC to Tajikistan and several economic integration economic integration determinants as a developing country, in an attempt to determine the rationality of Tajikistan joining EurAsEC beyond the traditional static and dynamic effects. Finally, section five will draw some conclusions.

1.2. Brief overview of Tajikistan

Located in Central Asia, the Republic of Tajikistan, with 8,2 million population, covers 142,600 square Km. The country is bordered on the west and north with the Republics of Uzbekistan (1.161km) and Kyrgyzstan (870 km); on the south with Afghanistan (1.206km) and on the east with China (414 km), (Map 4.1). By the surface nature, the country is a typical mountainous, 93 percent of its territory is covered by mountains that are known such as highest mountain systems of Central Asia (the Tien Shan and Pamir), with absolute heights from 300 to 7.495 meters.

In the scope of the EurAsEC region, Tajikistan is the smallest country and it is a double-landlocked country as, from one side, the country is cut off from China due to the highest mountain ranges and deserts; from another side, security concerns in Afghanistan present an insuperable transit barrier to the south (Coulibaly, 2012). Therefore, in comparison to other EurAsEC landlocked countries, Tajikistan suffers from several more disadvantages[75].

Map 4.1: The Political Map of Tajikistan

Source: adopted from www.lahistoriaconmapas.com

[75] Moreover, Tajikistan has to contend with the obstructionist policies and actions and the prevalence of informal payments at the border-crossing points with Uzbekistan. This is relevant since most traffic to major markets, like Western Europe and the Russian Federation, will need to transit through Uzbekistan (Asian Development Bank, 2009).

After gaining independence, the country's economy was in a grave recession because of the strongly dependence on Soviet Union that was unable to carry out transition system (unskillfully implemented economic reforms). As a result, this ended in a civil war situation which was worse than those problems. Although the country faced profound backwardness and the post-independence challenges, Tajik government made significant progress in macroeconomic stabilization through numerous economic reforms. However, in spite of several programs and reforms, Tajikistan still has a significant unfinished reform plans.

This mountainous country has one of the great potential opportunities of hydropower in the region (EDB, 2013). While in the frame of EurAsEC, Russia and Kazakhstan possess significant reserved of hydrocarbons (oil, natural gas, etc.) and various metals, Kyrgyzstan and Tajikistan economies are determined by their large possessions of water resources (Kuzmina, 2012). In particular, on the territory of Tajikistan about 64 km3 of water resource or approximately 55,4 percent of surface flow of the Aral Sea basin are found.

Therefore, the capacities of Tajik Hydropower from its glaciers are vital for this country and also for the region. Then, the hydropower is an important branch of country's economy, accumulating a significant share of FDI in some years (as we will see later). According to EDB (2013), hydropower potential is about 527 billion kWh per year, and the amount that is commercially available and economically viable for development is estimated around 317 billion kWh, of which today are used only 17 billion kWh. In general, the potential hydropower resource of Tajikistan ranks eighth in the world after China, Russia, USA, Brazil, Zaire, India and Canada. It is remarkable the fact that one of the main targets of EurAsEC is the creation of common energy space for the long term among member countries.

The economy of Tajikistan is agro-industrial, since its basis is agriculture: cotton, crops, livestock and industry, mechanical engineering, production of aluminum, fertilizer, textile and light industry, energy and consumer goods. The relative remoteness and isolation from the current world transport infrastructure,[76] the mountainous terrain and lack

[76] Tajikistan logistics performance is one of the poorest of the world: for instance, according to Doing Business 2012, eleven documents are required to export in compared to only six in Moldova which is another landlocked ECA country; eighty-two days are required to export a standard container compared

of access to the sea are determining the disadvantageous economic and geographical position.

1.3. Potential dynamic effects of EurAsEC

Dynamic effects are those that influence the accumulation of factors, broadly defined, and consequently, affect the growth in per-capita income (Baldwin, 1993). So, dynamic effects, which transform productive structure to a more competitive and specialized one, will be long lasting or anything that affects the country's rate of economic growth over the medium term (Balassa, 1961, 1975; Schiff and Winters, 1998).

Then, we focus in this section in the evolution of the economic growth of Tajikistan, measured by GDP growth, into the context of EurAsEC. Since one of the most important dynamic effects of integration influencing economic growth are its effects on investment activity and, in particular, on foreign direct investment (FDI), we will also analyze the FDI performance of Tajikistan.

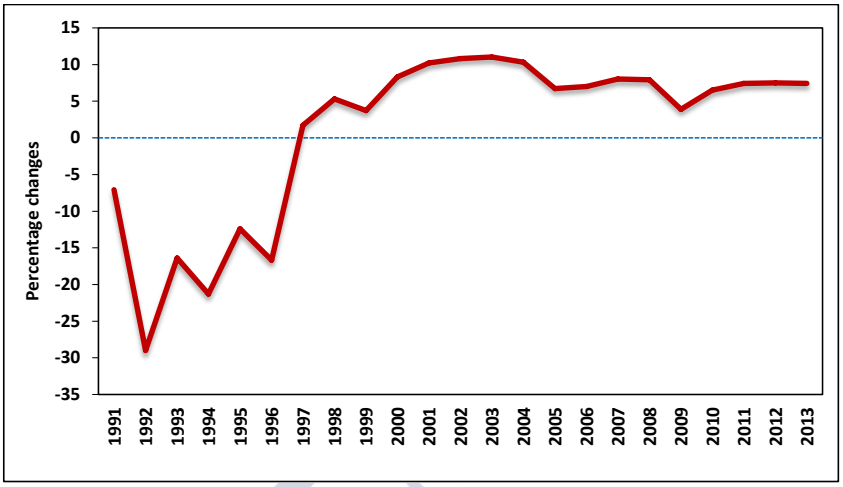
1.3.1. Growth effects

In early 1997, immediately after the signing of Tajik peace, the economy of the country recovered from the severe transition related from one side to the Soviet Union recession and from another side to the civil conflict of the 1990s. Macroeconomic performance improved in overall and the strong growth averaged in 2000 around 8.3 percent after -29 percent in 1991 was accompanied by other positive outcomes.[77]

to only 32 in Moldova; and exporting a standard container to the US costs on average $3,850 compared to $1.545 in Moldova (Coulibaly, 2012)

[77] For instance, a drop of the inflation rate from 32-38 percent in 2000-2001 to 6-7 percent in 2005-2009; an increase of imports from 810 mln $ in 1995 to 3272.6 mln $ in 2007 and of exports from 748.9mln $ to 1440.9mln$. In addition, the external debt moved to more manageable levels from 53.6 percent to 34.6 percent of GDP (Demidenko, 2013) which was largely attributable to this growth performance.

Graph 4.1: GDP growth rate of Tajikistan, 1991-2013



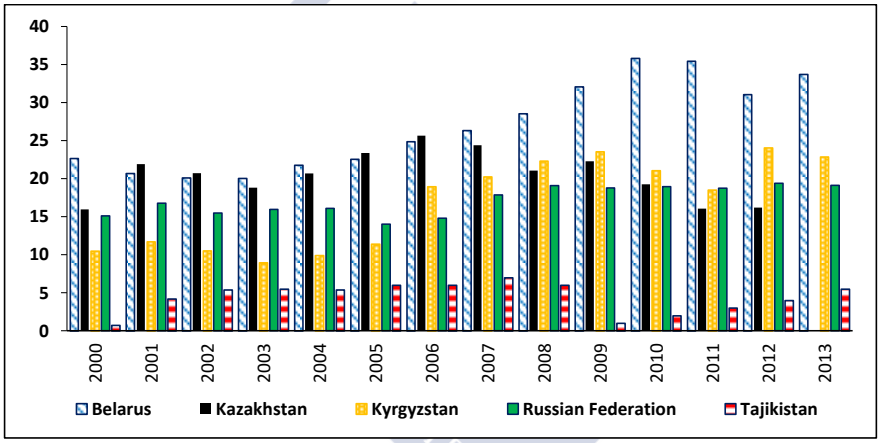
Source: Own elaboration based on World Bank Development Indicators Data

From 2000 to 2013 in the Republic of Tajikistan the positive trend of real GDP growth is observed almost in all years, except in 2009, when the decline in GDP growth is largely associated with the financial global crisis and economic growth slowed down to 3.4 percent from an average of around 9 percent between 2000 and 2008 (Graph 4.1). In general, macroeconomic stabilization has been driven by some notable developments: first, but the least important, the export performance, namely in previous years when the world price of cotton and aluminum were high. In a second term, economic growth was supported by development assistance from multilateral and bilateral development partners in the context of integration with the global community. Thanks to such financial assistance and the external borrowing, the country has managed to maintain high economic growth over the prolonged period of time, (Akramov and Shreedhar, 2012; Vinokurov et al, 2013). Third, remittances (mainly from Russia) had significantly contributed to Tajikistan's growth since 2004, to the point of the remittances inflows (50% of GDP in 2013) were the key drivers of poverty reduction and of contribution to the growth of domestic demand for goods (food and agriculture products), as well as of inducing construction and manufacturing services.

The dependence of Tajikistan' economic growth on those mentioned factors is a major source of macroeconomic vulnerability. As the World Bank (2011) stated, despite the relatively stable macroeconomic indicators, Tajikistan's economy remains dependent

on external factors. The country is highly dependent on imports of fuel and food since the main source of financing of imports and foreign exchange inflows into the country are export revenues (very low) and significant inflows of remittance transfers from Russia, the most vulnerability source. As long as remittance inflows are stable, Tajikistan can continue enjoying higher growth rates on the account of strong domestic consumption. But the experience of developing countries that have grown sustainably over decade shows that higher investments and export expansion aiming to call for global demand are essential ingredients, although in Tajikistan there isn't much evidence that remittances have fueled private investment (Coulibaly, 2012).[78] Gross Fixed capital formation undertaken by private sector is low compared with the other EurAsEc members (Graph 4.2).

Graph 4.2: Gross fixed capital formation, private sector (% of GDP)



Source: Own elaboration based on World Bank Development Indicators Data

Related with the country's vulnerability, one can suggest that the decline of the Russian economy[79], where more than 90% of migrants from Tajikistan are employed, leads to a drop in demand and economic growth, and also has an unfavorable effect on

[78] Indeed, Tajikistan statistics agency data indicates that the share of private investment in agriculture, trade and light industry (sectors reportedly receiving investment from migrants) has decreased from 2 to less than 1 percent between 2007 and 2008, when remittance inflows were reaching record levels. This situation makes an export-led growth strategy more difficult to achieve, particularly given that the country cannot rely on domestic demand from its eight million people to grow sustainably (Coulibaly, 2012).

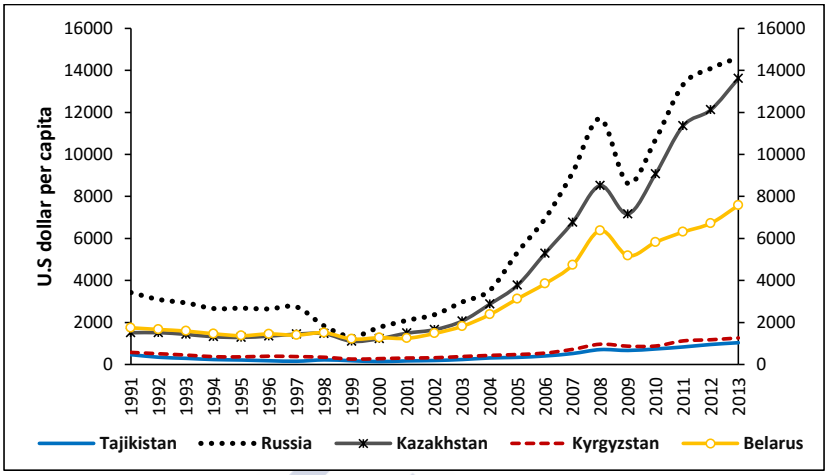
[79] Recent slowdowns in the Russian and Chinese economies, low commodity prices, and currency fluctuations are hampering economic growth in Tajikistan. By some estimates, the dollar value of remittances from Russia to Tajikistan dropped by more than 40% in 2014. The government faces challenges financing the public debt, which is equivalent to 35% of GDP, and the National Bank of Tajikistan has aggressively spent down reserves to bolster the weakening somoni, leaving little space for fiscal or monetary measures to counter any additional economic shocks (World-factbook, 2016). https://www.cia.gov/library/publications/the-world-factbook/fields/2116.html

government revenue that, consequently, increase the budget deficit. Another issue that Tajikistan is dependent on is the interruptions in transit through Uzbekistan and high transportation costs that have adverse economic and fiscal effects (Vinokurov et al, 2013).

Economic growth has been noticed not only in Tajikistan, but almost in all EurAsEC countries by promoting the period of transition and stabilization. The average GDP growth rates in majority of these countries were higher than those in other developing countries (Tai and Lee, 2009). Particularly, during the period from 2001 to 2006, the average annual GDP growth rate was 8.9 percent in the most of these countries compared with 6.5 percent in other developing countries. The majority of EurAsEC countries showed a faster GDP growth in this period as the result of the high oil and gas world prices (Kazakhstan and Russia) or to a fewer extent, growth of production in the manufacturing sector (Russia and Belarus). Some years ago, the Asian Development Bank (ADB, 2009) predicted that the growth of these countries would continue by expanding their capacities to meet the larger demand from growing Asian economies, particularly from that of the People's Republic of China (PRC). Foreign direct investments (FDI) in hydrocarbon industries are expected to grow, especially in Kazakhstan. Today one can observe such proper prediction, also in the case of Tajikistan and Kyrgyzstan, in terms of good relationship with China.

Nonetheless, the relationship between **GDP per capita** and contributions of faster economic growth during the past decade reflecting rising of remittances inflows as well as imports, resulting sharp reduction in poverty rate remain uncertain. The considerable economic growth of Tajikistan is very similar to EurAsEC countries, but country's GDP per capita is still significantly below all the EurAsEC members and nearly 35 percent population still lives under the absolute poverty line.

Graph 4.3: GDP per capita of EurAsEC members ($ current Dollars)



Source: Own elaboration from World Bank data

Although the increase in country's GDP per capita is considerable, from 212 (U.S. Dollar) in 1991 to 1.036,6 (U.S. dollar) in 2013, in comparing with most of the EurAsEC countries it is negligible (Graph 4. 3). In terms of GDP per capita we observe two country groups in the frame of the EurAsEC: one group formed by Russia, Kazakhstan and Belarus, and the other one by Kyrgyzstan and Tajikistan that are less advanced in terms of transition to the market economy. GDP per capita of Tajikistan is in the lowest position in the context of EurAsEC member countries. One fundamental reason is that while Tajikistan was striving against its post war poverty other EurAsEC countries almost have successfully finished their economic transition reforms.

However, by looking at this issue from the beginning, we can say that Tajikistan as the typical economy which dependent on agriculture, with a quite remote and a mostly mountainous landscape, having a lower income per capita in the Soviet period within USSR Republics still has the lowest income per capita among the CIS and EurAsEC countries. So, the low income with the large agrarian share should induce to efforts for agricultural and overall efficient economic reforms[80] for improving the population's well-being (Amir and Berry, 2012).

[80] More generally, the importance of reforming the agricultural sector is fundamental to achieving food security and equitable growth in the country (an important first step is to generate pro-poor growth, which means strong employment). Then, freedom to decide which crops to sow, access to secure and transferable land use rights and investments in rural infrastructure are all central to this goal. Currently, too many young Tajiks are deciding that it is pointless to apply for land ownership and that the best option is to leave farming and migrate to Russia to look for work there (Omair Amir and Albert Berry, 2012).

In relation with this, Coulibaly (2012) has identified production capacity binding constraints to export diversification and poor market accessibility as the major constraints to growth in Tajikistan. Moreover, he has found that poor business environment[81] seems to be the most binding constraint to growth in Tajikistan, both in agribusiness and urban services. If the government anchors its growth strategy on improving labor productivity through general-purpose training, leaving the prospect to expand hydropower capacity to the private sector, not only the productivity of migrants but also workers involved in agribusiness and industrial production will improve and in turn improve the country's growth prospect. In addition, International Institutions as World Bank Group (2013) and IMF (2012) gave some policy recommendation sustaining inclusive growth that will require Tajikistan to address the following challenges; (i) high vulnerability to macroeconomic shocks and climate change, (ii) poor quality of public services and unequal access to them, (iii) lack of well-functioning and easily accessible markets.

As a result, maximizing the return from migration through general purpose training allowing diversifying destination countries and better channeling of remittances through an improved financial sector seems the first-step of a successful growth strategy. Finally, from the point behind the investment effects, there is FDI that is induced by regional integration as a catalyst to greater growth; hereafter we provide FDI performance of Tajikistan.

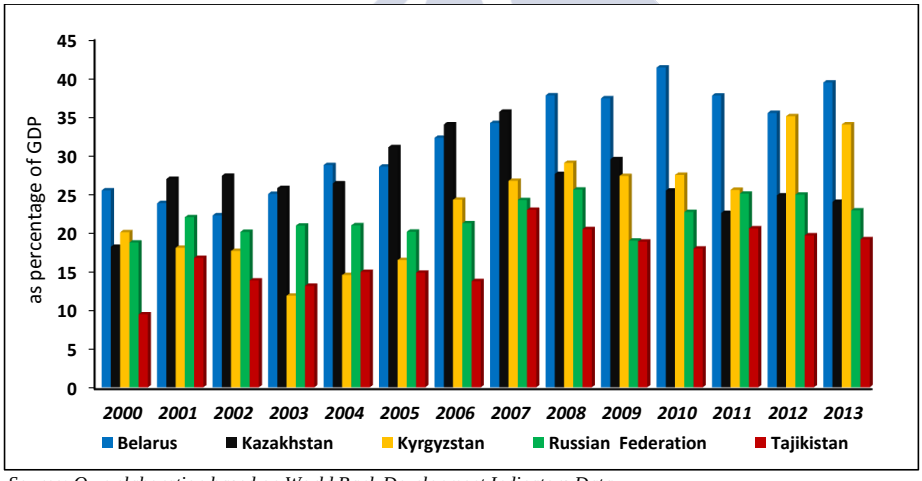
1.1.1 1.3.2. Foreign Direct Investment (FDI)

Since an important share of investment in developing countries is foreign direct investment (FDI), the increase of FDI induced by regional integration is seen as a catalyst to efficiency gains, increases of overall factor productivity and greater growth rates (Blomstrom and Kokko, 1997). So, attracting FDI is a major incentive for integration for developing countries. FDI not only provides capital investment but also technology (know-how) transfer and diffusion, mainly due to the spillovers to local firms (Egger and Pfaffermays, 2002; Uttama and Peridy, 2009). As several works show, these spillovers of technology transfer from FDI are especially relevant for developing countries where most of the inward FDIs come from the developed ones (Peiris et al, 2015).

[81] Main obstacles of poor business environment are: government regulation and measures that weaken the business climate; weak anti-corruption as a result of informal taxation which increases the cost of doing business, expensive and unreliable communication system; increase in the cost of trade and restricted access to markets and technology; inefficient customs administration, as well as shortcomings in the provision of transport services in Tajikistan (Coulibaly, 2012).

In the early years of independence, pursuing undecided reforms and privatizations, Tajik government has shown interest in broader foreign investment. Consequently, Tajikistan's State Committee on Investments and State Property was created in 2006 to assist investors. The agency has contributed to the development of the investment climate, including limited reforms in business legislation that increased Tajikistan's ranking in the World Bank's "Doing Business" index from 152 in 2011 to 147 (out of 183 countries) in 2012. Moreover, some improvements have been made such as enforcing contracts, protecting investors, starting a business and registering property. The most significant reform was the grand opening of a "single-window"[82] business registration system in July 2009, which applies to both foreign and domestic applicants, and reduces red tape associated with the process of opening a business. After all that, investment, measured by the Gross Fixed Capital Formation, as a percentage of GDP has increased in Tajikistan from 7.4% in 2000 to 14.1% in 2013, but rates over the period are lower than for other members of EurAsEC (Graph 4.4).

Graph 4.4: Gross Fixed Capital Formation as percentage of GDP



Source: Own elaboration based on World Bank Development Indicators Data

After all mentioned changes, the poor business climate remains as an obstacle to attract investment; as a result, this Committee has done little to fulfill its mission (Bureau

[82] Applicants now pay a fixed fee at the Tax Committee and are supposed to receive permission to begin operating within five working days. In 2011other targeted reforms were enacted, including a law improving the rights of minority shareholders. Given Tajikistan's paucity of corporations, with or without minority shareholders, this law has limited scope in practice. http://www.state.gov/e/eb/rls/othr/ics/2012/191246.htm

of economic and business affairs, 2012). In other words, the lack of a national FDI promotion strategy and transparent investment policies hinder its capacity to attract foreign investment.

What is more, in order to further promote foreign direct investment and develop a real sector of the economy, the Government has drafted a new law on free economic zones (FEZ)[83] in the RT, which is currently being reviewed by the Parliament. Two of Tajikistan's four FEZs are currently active: Sughd and Panj. The other two, Dangara and Ishkashim, are still under development. Companies operating in the FEZs are exempt from taxes for the first seven years. The FEZs are regulated by the Law on Free Economic Zone[84]. Sughd Free Economic Zone is the most developed zone in the country, located less than 15 kilometres from Khujand City with access to an international airport and railways. The zone has attracted foreign investment of $130 million in mining, aluminum alloy processing, solar panel manufacturing and agricultural product processing (UNCDAT, 2014).

According to the available literature (Vinokurov et al.,2013; FAO, 2014; UNCDAT, 2014; State Statistical Agency of Tajikistan and Investment Committee of Tajikistan), FDI in Tajikistan has been dominated by investors such as Russia, China, Iran, Kazakhstan, and International financial organizations like WTO. These principal investors in recent years are governments with geopolitical interests in the region (UNCDAT, 2014). According to the Bureau of economic and business affairs (2012), Tajikistan mostly looks after state-led investment and external loans from the country's perceived geopolitical friends rather than making conditions favorable to private investors from abroad.

Through non-transparent practices and barriers to competition, the government burdens the private sector[85] with unnecessary costs and creates substantial uncertainty and

[83] Draft law provides for legal and economic basis of organization and functioning of FEZ as separate areas with special customs and tax regimes within their boundaries, including full or partial relief from customs tariff when importing goods to FEZ; simplified procedure for transportation of goods and vehicles across FEZ boundaries; and cancellation of non-tariff restrictions. It is also proposed that legal and physical persons Residence and non-residents duly registered on the territory of FEZ will receive full or partial exemption from taxes and other contributions during their operating in FEZ, if they are directed into production on the territory of the RT It is expected that this law will come into force soon. See: http://www.investin.info/country/tajikistan/facts-and-figures/?country=tajikistan).

[84] See: .(http://www.tajinvest.tj/?q=en/node/147)

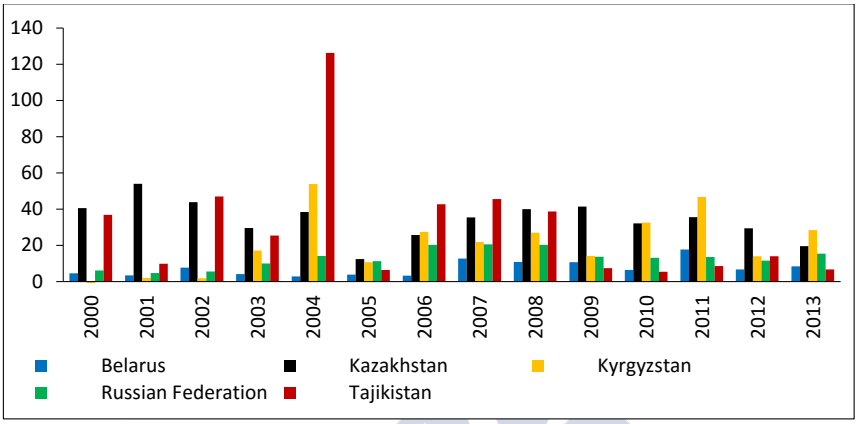
[85] Tajikistan's biggest challenge in the coming years will be lifting its low rates of private investment, and this requires a better investment climate. Existing regulations for starting a business are still too restrictive and past arbitrary government actions have discouraged investors. In addition, poor reliability of electricity supply, difficult tax administration processes, and insufficient storage facilities, among other hindrances, reduce private investment profitability even in the cities (World Bank, 2011)

risk. The vast priority areas of FDI opportunities are directed to the hydroelectric power, mining sector (primary aluminum) and agriculture development, especially, deep processing of cotton fibers. Banking sector, service industry, tourism and manufacture of construction materials are the sectors receiving the second greater investment support. More than 210 joint ventures are established in Tajikistan with these main activities (Vinokurov et al., 2013).

Some examples: the construction of the Sangtuda-1, in the frame of hydropower branch and in the light industry, the cotton processing and export of textile products by the company of "Eurasia-Textile" were held by Russia. Most of the investment projects in the agricultural sector including food industry were fulfilled by Kazakhstan, projects such as the increasing facilities in grain storage and infrastructure development for export grain by "Ivolga-Holding" company, as well as obtaining agricultural machinery project by JSC "Holding Kazexportastyk". The project of “Supply of wheat” by TNK "Agricultural", also was invested by Kazakhstan. China and Iran as other major investors have been active in recent years. China held the joint venture gold mining project with its Zijing Mining Company; and Iran (Eximbank) was a financing source (256 million U.S dollars) for the Construction of Sangtuda HPP-2 (220 MW) project in 2011. Additionally, in the field of nonferrous metallurgy, Iranian Alumina Company invests in alumina supply project. The United Kingdom was another active investor in 2011 with $27.7 million in FDI of Tajikistan for the processing of fruits and vegetables through Geha-Food Company. Other large foreign investors in Tajikistan include the "CASA 1000" project that was a financing source (700 million U.S dollar) in 2015 for the Commissioning the first phase of the Rogun HPP (800 MW) and the World Bank with the project for the development of the silver and zinc deposit "Konimansurikalon". In spite of the several investor projects that were mentioned above, in comparison of other EurAsEC members, Tajikistan lags with much smaller investors behind its neighbors. It is also essential to emphasize that in the context of integration agreements, there is no active regional investment arrangement in the case of Tajikistan, except the CJSC "Olim-Textile" by Eurasian Development Bank (Vinokurov et al., 2013). In 2009, this project was an investor for the construction of a modern spinning factory, for an upcoming export to Russia. The size of the EDB's participation in the project amounted to $ 22.57 million at total investment of $ 29.75 million. At the same time, at the bilateral level, each EurAsEC country has concluded multiple bilateral

investment treaties (BITs) with key investment partners. Last years, foreign direct investment remains at a low percentage of Gross Fixed Capital Formation (GFCF), lower than that for other EurAsEC countries having much higher GFCF as percentage of GDP and GDP levels (Graph 4.5).

Graph 4.5: Inward FDI as a percentage of Gross Fixed Capital Formation



Source: Own elaboration based on World Bank Development Indicators Data

The hydropower as an important branch of country's economy accumulated a significant share of FDI (165.4 million U.S dollar) in 2007 and (243.6 million U.S dollar) in 2008. This can be one of the explanations for the increasing FDI in these particular years as shown in the Graph 4. However, in 2009 the share of FDI in hydropower sharply decreased (10 million U.S dollar) due to the certain difficulties concerning both political and economic nature[86].

In a different aspect, corruption might be the most highlighted reason for the low level of FDI in Tajikistan, as Tajikistan ranked very low in the 2014 in the Corruption Perceptions Index. In Transparency International data, it scored 23 out of 100, placing it 152 on a list of 174 countries[87]. As the Bureau of economic and business affairs (2012) has mentioned, Tajikistan presents selected opportunities for investors who are willing to put significant research and effort into market development and who have local experience or

[86] Explanation of increasing and decreasing FDI in hydropower is related with the construction of the Sangtuda-1, which held with the participation of Russia, ended quite successfully, but the construction of the Rogun hydroelectric power station has not been completed. Since the project required reassessment and revision in connection with the current requirements for such large-scale construction projects that have transboundary impacts (Vinokurov et al, 2013).

[87] http://www.transparency.org/cpi2014/results

contacts to help navigate the maze of bureaucracy and corruption. According to this Bureau, the government's policies have dramatically worsened the investment climate[88]. As have been mentioned above, another explanation for the poor FDI in the country is the lack of favorable investment conditions and poor business environment. Gaps still exist in the legislation and the interpretation of laws and regulations, which may cause uncertainties for foreign investors. In fact, the Bureau of economic and business affairs (2012) properly stressed that until Tajikistan successfully struggles with such basic problems, it will not attract significant growth in foreign direct investment.

1.4. The rationality of Tajikistan joining EurAsEC beyond traditional effects of integration

As it was discussed in chapter one, the traditional welfare effects of economic integration, not just of the static ones (in terms of trade creation and trade diversion) but also in some extent of the dynamic ones (influencing growth rates), are not fully applicable to integration agreements involving developing countries (Meier, 1960; Balassa, 1965; Mackay, 1984; De Melo, 2011). The literature of economic integration theory was concentrated on the rationality of a customs union relying exclusively upon industrialized countries which are interested in tariff issues and production/consumption shifts (Balassa, 1965). The environment and difficulties of the developing countries are completely different; they are firstly interested in economic development. So, the welfare effects of economic integration involving developing and less developed countries should also encompass the positive effects of employment, productivity and income effects, production specialization, competitiveness, etc. (Abdel Jaber, 1971).

From a developing country point of view, the answers for questions about (1) the welfare effects of economic integration and (2) the factors that affect the desirability of economic integration given for developed countries present limitations (Hosny, 2013). So, the determinants that influence the motivation of developing countries to participate in integration agreements must be addressed separately. Following Marinov (2014), the potential effects and factors which are relevant for developing countries, constituting the

[88] For instance through the coercive campaign to force businesses to contribute to the construction of the Roghun dam and projects celebrating 20 years of Tajik independence. Tajikistan's tax code remains byzantine, its legislation is confusing, and, more than anything else, its officials remain mired in a culture of corruption.

economic determinants of integration beyond the traditional static and dynamic effects, are organized into three categories: general economic perspective, market-related, and trade-related determinants. In addition to economic determinants, there are also several political incentives of economic integration that are of special importance to developing countries. In what follows we present outcomes for some of these economic and political determinants, which can give rationality to the decision of Tajikistan join EurAsEC, in spite of weak static and dynamic traditional effects.

1.4.1. General economic perspective

1.4.1.1. Objective of Economic Development

Since the ultimate objective of economic integration is the welfare effect (Balassa, 1975), many countries, especially the less developed ones, sign integration agreements considering firstly the objective of economic development. For these countries integration should be regarded as a development instrument rather than a trade policy (Abdel Jaber, 1971). The main objective is not a better resource allocation but the benefits from faster growth and full utilization of resources and production factors, (Marinov, 2014). At this regard, Tajikistan along with other less developed countries participates into integration agreements and other international organizations[89] first of all considering the importance of the economic and political development under the common projects such as poverty alleviation, education and health challenges, infrastructure development as well as the promotion of peace and security within the country.

In fact, poverty alleviation is one of the fundamental objectives of Tajikistan economic development policy. Tajik poverty issue is not new, since it was widely recognized as one of the poorest republics of the Soviet Union. In 1989, just prior to 'transition', 51 percent of the population had a per capita monthly income below 75 rubles, compared with 33 percent of the population in Kyrgyzstan, 16 percent in Kazakhstan and 5 percent in Russia (Atkinson and Micklewright, 1992).

[89] Participation of the Republic of Tajikistan in the WTO activities is one of the priority issues of the economic development of the country. This program is aimed at reducing unemployment through the creation of appropriate conditions for the new jobs, reducing poverty and raising living standards of the population United Nations, (2015). Economic and Social Council. Tajikistan: World Trade Organization post accession plan. Original: Russian. pp. 1-27.

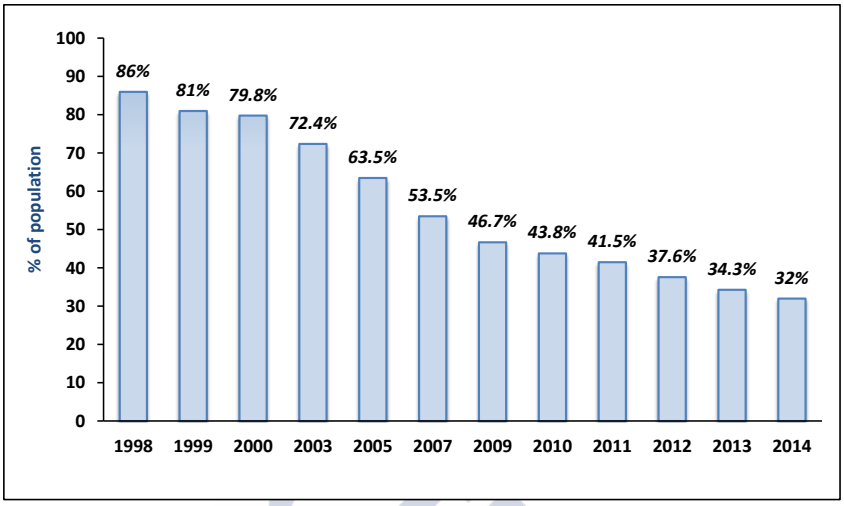
Along with transition challenges, the civil war was other factor seriously affecting both economic and social spheres of the country that finally led to profound economic crisis and to a shortage of necessary products. Consequently, immediately after the war (1997), around 95% of Tajikistan's population was living below the minimum consumption basket (Falkingham, 2000; World Bank, 2004; IMF, 2011). Falkingham (2000) has classified the country's poverty such as four out of five are 'poor', a third are 'very poor' and nearly 20 percent 'extremely poor' (below $1 PPP a day).

The situation started changing only after 1997, when a peace agreement was signed between the United Tajik Opposition and the government. Rapid growth helped to significantly decline the poverty rates, measured by the national poverty line[90] that fell from over 80 percent to about 32 percent during the period 1999-2014 (Graph 4.6). The main drivers of poverty reduction were the labor earnings and remittances. Between 2003 and 2009 income poverty reduction was about 36 percentage points, of this total (labor earnings accounted by 21 percentage points and remittances by 8 percentage points; new employment opportunities contributed minimally), Azevedo et al., (2014). The role of remittances in poverty reduction was even more important after 2009, since the share of remittances in GDP grew from 35% in 2009 to 52% in 2012.

It should be noted that drivers of poverty alleviation differ slightly across urban and rural areas. If labor market gains were more beneficial for urban area, remittances played a more important role for rural residents, since they were responsible for 24 percent of total income poverty reduction in rural areas and only for 18 percent in urban areas between 2003 and 2009. Moreover, remittances and labor earnings are more important for the welfare improvement of the middle class, while employment opportunities and pensions are more important for the poor/vulnerable population.

[90] Poverty line is taken as 2.50US$/PPP per day.

Graph 4. 6: Poverty reduction trends in Tajikistan, measured by the national poverty lines,[91] (1998 -2014)



Source: own elaboration based on data of Taj Stat, TLSS 1999-2009 and HBS 2010- 2014

Compared with other Central Asian countries, inequality in consumption per capita, measured by the Gini coefficient, was not high in Tajikistan and was falling from 0.33 in 2003 to 0.31 in 2009. The main contribution to inequality reduction was played by employment. Although remittances could positively contribute to poverty reduction it could increase inequality, since international migration option is not necessarily accessible to the poorest population.

The National Development Strategy in 2015 was initiated to regulate the development process of the country, taking into account the long-term perspective within the "Millennium Development Goals", which currently was implemented through medium-term Poverty Reduction Strategies. In addition, as we mentioned above, since Tajikistan takes part into integration agreements and International organizations with the fundamental special objectives as poverty alleviation, the social assistance through such organizations helped also to reduce the extreme poverty rate, particularly in rural areas; extreme poverty

[91] The poverty line in Tajikistan was estimated based on the international poverty measurement ($2.50 PPP per capital per day). Between 1999 and 2009 this approach relied on the Living Standard Measurement Surveys (LSMS) to measure poverty, primarily prepared and financed by the World Bank (WB). Since 2010, the poverty rate of Tajikistan is estimated using a national Household Budget Survey (HBS) from the Agency on Statistics (TajStat). This approach is an internationally-recognized poverty-measurement methodology: the absolute poverty line for the HBS survey is defined by the cost-of-basic-needs method (CBN). In estimating the food poverty line, the average kilocalorie requirement (AKR) is set at 2,250 kilocalories per-person per-day (TajStat, 2015).

rates, based on the food poverty line, declined from 42% in 2003 to 18% in 2009 (Acevedo et al 2014).

Moreover, agricultural production by private household plots and collective household farmers has become a vital solution for the household's welfare development, influencing positively in decreasing poverty. At the same time, Tajikistan is one of the most vulnerable countries in terms of climate change[92], one of the reasons making poverty reduction so difficult.

The Tajikistan's pace of poverty reduction over the past 15 years has been among the top 10 in the world. Thus, to date, in Tajikistan more than a million people have moved out of the poor zone.[93] However, the country did not do so well in reducing non-monetary poverty. According to World Bank Group (2013), recently available micro-data suggest that limited or no access to education (secondary and tertiary), heating, and sanitation are the main contributors to non-monetary poverty. These three are the most unequally distributed services, with access to education varying by income level and heating and sanitation according to location. Consequently, despite high poverty alleviation, Tajikistan is still considered as one of the poorest country in the region (Table 4.1).

The economic growth rate, a necessary condition, was quite high during this period, but not a sufficient condition for poverty reduction, due to the inefficiency and vulnerability of economic circumstances. Although economic growth was observed in all sectors of the economy in Tajikistan, it was not accompanied by comparable employment growth. About the relationship between growth and poverty, World Bank Group, (2013) and IMF (2011) suggested that the most effective way to translate growth into higher incomes is through the generation of more and better jobs based on private sector investment. We will present later on the document the performance of the labor market.

[92] The country is often affected by droughts, floods and soil erosion and the problem is exacerbated by a limited technical capacity of the country to forecast and react to natural disasters (World Bank Group, 2013).This type of shocks are particularly devastating to the agricultural sector and households depending on them. According to DCC (2012), a 10 percent decrease in agricultural income would result in a 7 percent increase in poverty.

[93] http://www.worldbank.org/en/country/tajikistan/overview

Table 4.1 Poverty and HDI in EurAsEC Countries, 2000 and 2014

	Poverty*		HDI	
	2000	**2014**	**2000**	**2014**
Belarus	41.9%	4.8%	0.683	0.798
Kazakhstan	46.7%	2.8%	0.679	0.788
Kyrgyzstan	62.0%**	30.6%	0.593	0.655
Russia	24.6%	11.0%	0.717	0.798
Tajikistan	79.8%***	32.0%	0.535	0.624

Source: Own elaboration based on data from the World Bank Indicator

Notes:

* Percentage of the population living below the national poverty lines.

** From UNDP http://www.kg.undp.org/content/kyrgyzstan/en/home/countryinfo.html

*** From the Taj Stat data

Since development is the main objective from integration for developing countries, along with the poverty alleviation, other important issues regarding the improving of standards and quality of life are promoting healthcare and education. Therefore, here we turn to this issue in the context of the **Human Development Index (HDI)** evolution in the case of Tajikistan**.**

On the eve of the Soviet Union collapse and in the early morning of Independence, Tajikistan along with most of the post-Soviet countries had relatively high human development indicators, reflecting the heritage of economic and social development achieved during the Soviet empire. However, with the disintegration result and civil war HDI has fallen sharply from 0.629 in 1991 to 0.535 in 2000. It is clear that the decline in the HD Index during this time indicates that the relative position of life expectancy, education and GDP in Tajikistan has been deteriorated. Although recent dates show that Tajikistan's HDI value increased, country's HDI is still behind most of other post-Soviet countries, especially to EurAsEC countries or its Central Asian neighbors (Table 4.1).

A review of Tajikistan's progress in each of the HDI indicators is provided in Table 2. To allow assessment of Tajikistan progress in HDIs, Table 2 includes recalculated HDIs from 1990 to 2014 using consistent series of data (UNDP, 2015).[94]

[94] Calculations are based on international data from the United Nations Population Division (the life expectancy data), the United Nations Educational, Scientific and Cultural Organization Institute for Statistics and the World Bank (the GNI per capita data).

Table 4.2: Trends in Tajikistan's HDI component indices 1990-2014

	1990	1995	2000	2005	2010	2014
HDI value	0.616	0.539	0.535	0.579	0.608	0.624
Life expectancy	62.9	62.3	63.5	65.9	68.4	69.4
Expected years of schooling	12.0	10.3	9.7	10.7	11.2	11.2
Mean years of schooling	9.6	10.6	10.6	10.5	10.4	10.4
GNI per capita (2011 PPP$)	3630	1211	1134	1663	2083	2517
Source: Own elaboration based on data from UNDP report (2015)						

Despite a low level of GNI per capita, the Tajikistan's HDI value in 2014, which is about 0.624, put the country in the medium human development category, ranking 129 out of 188 countries. Between 1990 and 2014, Tajikistan's life expectancy at birth increased by nearly seven years, mean years of schooling increased by nearly one years, but Tajikistan's GNI per capita (in constant 2011 PPP$) decreased by about 30.7 percent between 1990 and 2014.

1.4.2. Market-related determinants

1.4.2.1. Employment and Productivity

In general, the market structure of the less developed countries determines that comparative advantage concentrates in the production and trade on a limited range of usually low technology goods (Mackay, 1984). Moreover, unemployment and under-employment of factors of production, together with a situation of low productivity, are major problems in developing countries (Hosny, 2013). So, a country can get gains from integration, even under trade diversion, if in that country there are labor shifts from low efficient to high-efficient sectors or activities, and a decreasing unemployment.

In Tajikistan labor market, 51% of employees do not have a permanent job, most of the employees are working on very small businesses or they are self-employed and almost two-thirds do not have employment contracts, i.e., they are informal employees[95].

[95] Despite some progress, informal employment is still prevailing in Tajikistan. There is a high level of informal employment both in agricultural and non-agricultural sectors of the total domestic employment. Other increasingly important challenge for Tajikistan is the youth unemployment (ILO, 2015). http://www.ilo.org/moscow/news/WCMS_378192/lang--en/index.htm

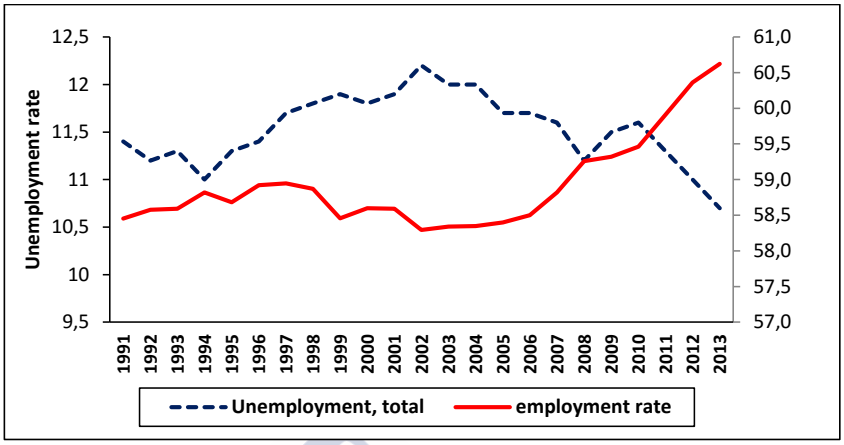
Agriculture is the only sector where a significant growth in the number of jobs is observed. Employment in non-agricultural sectors is growing very slowly or it is even stagnated.

After disintegration of the Soviet Union with resulting sectoral collapse and broken of linkage between all sectors of the national economy, labor market of Tajikistan was in a critical situation. Other main reasons for insufficient job places and lack of employment opportunities are inability functioning of domestic labor market and a rapid population growth (2.2% in 2013), Tajstat (2014). Rapid population growth resulted in a number of young people being four times more than the number of older working citizens (Vinokurov et al., 2013). Consequently, young workers face considerable difficulties in finding work and workers approaching retirement age are forced to retire early.[96]

According to TajStat (2014), the number of economically active population that includes employed and officially registered unemployed, in November 2013, stood at 2.26 million, of which 97.5% are employed and 2.5% have the official status of unemployed. While 2.5% reflects the situation for the registered unemployment, it is far from the real situation of unemployment (Avezedo et al, 2014). Since an important size of the economy is informal or shadow economy (41% in 2007, according to Schneider, 2012), the official figures show not the real situation of employment and unemployment as well as their response to economic changes. According to ILO estimations, the total unemployment rate goes from 11.4 in 1991 to 10.7 in 2013, while the employment rate (employment/population 15+) goes from 58.5 to 62.6 (Graph 4.7).

[96] It is somewhat unclear how much future demographic developments will accentuate the employment challenge from the labour supply side, where there is currently a major surplus. Tajikistan was in the midst of a bout of very fast population growth (around 3 percent per year) when the crises of the 1990s hit. Such a rate would be a serious barrier to the developmental hopes of most countries, but especially one with the limited options of this country. Since then, however, population growth has fallen considerably, to an estimated 1.5–1.9 percent by 2010.

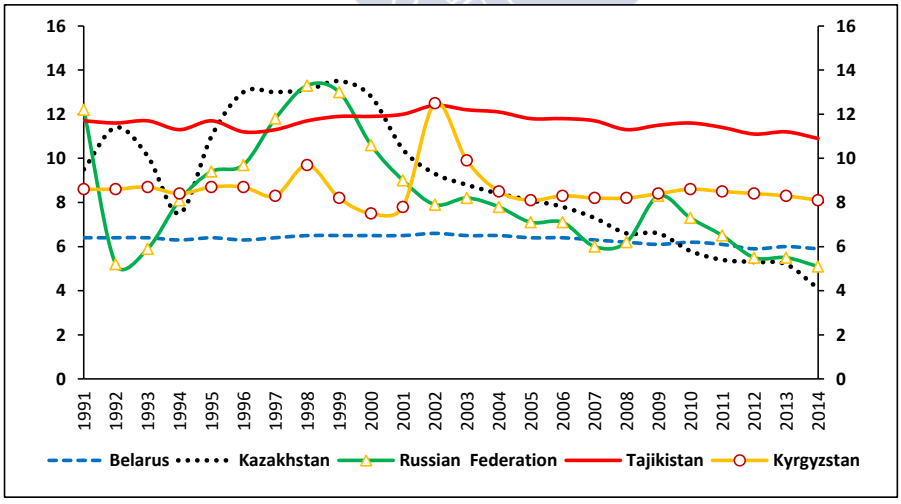
Graph 4.7: Unemployment and Employment rates in Tajikistan



Source: Own elaboration based on data from ILO Estimates and Projections of the Labor Market and WBI data

In spite of the positive evolution of the labor market, the relative position of Tajikistan into the region was not as positive. The unemployment rate in Tajikistan remains as the highest one of the EurAsEC countries (Graph 4.8). Moreover, vulnerable employment, defined by the ILO as the unpaid family workers and own-account workers as a percentage of total employment, accounted by 47% in Tajikistan in 2009, while in Russia and Belarus accounted by 6% and 2% respectively (ILO, Key Indicators of the Labour Market database).

Graph 4.8: Unemployment rates in EurAsEC countries

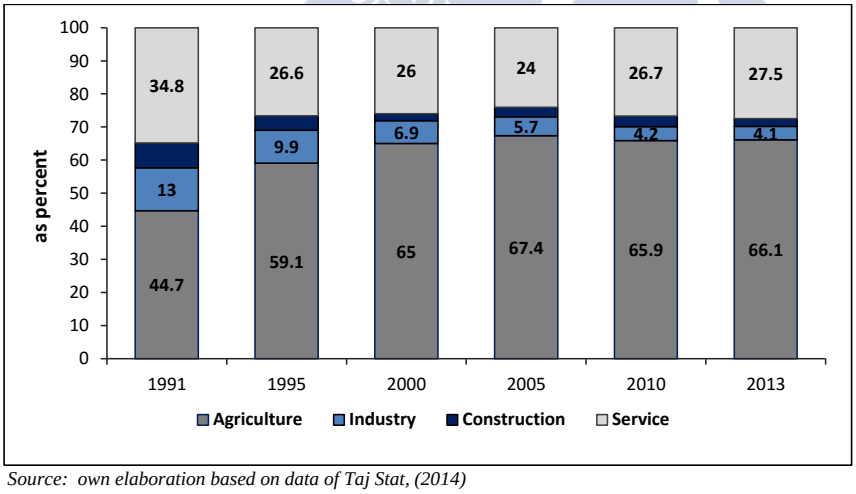


Source: Own elaboration based on WBI data

As a characteristic feature of transition economy, the share of state employers fell down from 19.8% in 2009 to 18.8% in 2013. Similarly, the share of collective employers also decreased from 24.9% in 2009 to 16.8% in 2013. At the same time there is a steady trend of growth in the share of employed in the private sector from 54% in 2009 to 63.3% in 2013 (TajStat, 2014).

While economic growth was observed in all sectors of the economy, it was not accompanied by comparable employment growth. All economic sectors grew at around 7 percent during the decade of 2000s; however, employment growth was not observed in industry and was modest in the large sectors, services and agriculture, being higher in the small construction sector (World Bank Group, 2013). A sectoral collapse during Soviet dissolution and ineffective functioning transition period remained the main reasons behind cease of industry for creation jobs in the domestic market; in industry workplace numbers decreased from 256 thousand in 1991 to 114 thousand in 2007, Kudusov (2010). So, the sectorial structure of employment remained unchanged since 1995, with a gradual decline in the share of industrial employment and a slowly increase in the proportion of people employed in the agricultural sector (Graph 4.9).

Graph 4.9: Sectorial structure of employment

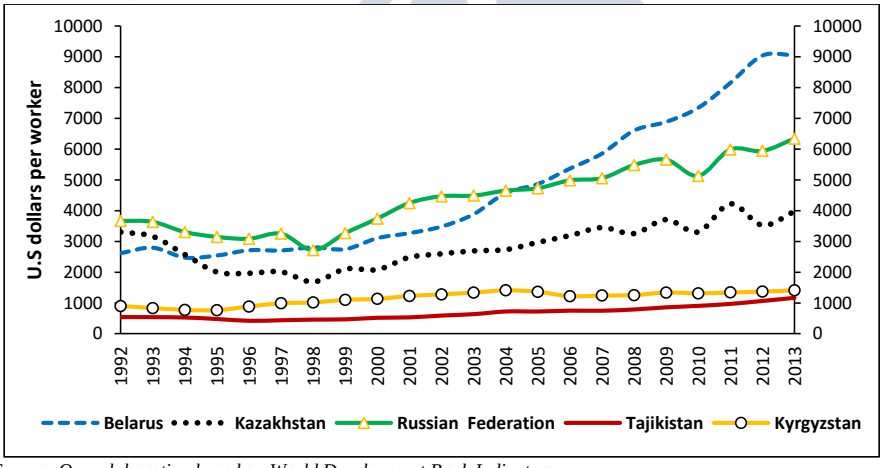


Source: own elaboration based on data of Taj Stat, (2014)

Although in Tajikistan the importance of agriculture has declined during the recent years, facing many problems,[97] it still remains one of the most important sectors (mainly, cotton fiber) by its contribution to GDP (27,4% in 2013)[98], export earnings and employment (66.1% of total employment), (Graph 4.7).[99] In fact, most of the jobs created during the period 2009-2012 (73,000), were created in the agricultural sector (Avezedo et al, 2014). From 1998 to 2007, jobs in agriculture increased from 1.090.000 to 1.430.000 (Kuddusov, 2010). Jobs were also created in other much better paid sectors, such as services and construction, but comparing with agriculture only in significantly low level, especially for the later one. Although industrial goods generate about three-fourths of the country's export earnings (due to a large contribution from the aluminum industry), the industrial employment decreased from 13% in 1991 to 4.1% of the total number of employed in the economy in 2013.

Although the value added per worker in agriculture has doubled in the period 1992-2013 in Tajikistan, it remains much lower than in the other EurAsEC countries (Graph 4.10).

Graph 4. 10 Agriculture productivity (value added per worker, constant 2005 US$)



Source: Own elaboration based on World Development Bank Indicators

[97] The main reasons for the reduction in agricultural output in the post-reform period were the discontinuation of state support, the collapse of the system providing agricultural inputs and its replacement by unscrupulous intermediaries like 'futures' companies (their total number today in the country is 46). As a result of their not honest activities, about 30,000 dehkan farms are now in a catastrophic state. The total debt of dehkan farms to 'futures' companies22 is about USD 488 million as of the beginning of 2008 (Kudusov, 2010)

[98] The contribution of agriculture to GDP in 2013 is lower in the other EurAsEC countries: 8% in Belarus, 4% in Russia, 5% in Kazakhstan and 17% in Kyrgyzstan.

[99] After the migration of male labor, feminization of agricultural households and poverty is an emerging phenomenon (Akramov and Shreedhar, 2012).

We share the conclusion of Kudusov (2010) saying that given the 73% of total population living in rural areas and 67% of total employment in agricultural sector, there is a pressing need for a comprehensive 'rural development strategy' and specific programmers for improving the labour productivity in agriculture. No national development strategy can ignore this substantial rural part which is also main source of labour emigration. As poverty is observed most acutely in rural areas, mostly deprived from basic education and health facilities, special measures targeting girls' education and women's employment should be foreseen and implemented rigorously in rural Tajikistan.

The answer to unemployment and poverty, especially in rural areas and by young people, has been migration. We next focus on labor migration and remittances.

1.4.2.2. Labor integration or Migrant Chaos

The key factors affecting the probability of migration are, in general, unemployment and household poverty (Brown et al, 2008). That is the case in Tajikistan, where the unfavorable situation in the domestic labor market (unemployment and low-paying jobs) encourages citizens to migrate and migration has a massive character.[100] Together with poor employment opportunities in Tajikistan and betters perspectives in Russia, Akramov and Shreedhar, (2014) suggested that significant wage differential between Russian and Tajik labor markets are also an important determinant of labor migration. Average earnings of migrants in Russia are about 370 US$ what are 4 times higher than their expected income in Tajikistan (for a prime age male average wage in 2009 was equal to 90 US$), Chernina and Lokshin, (2012).

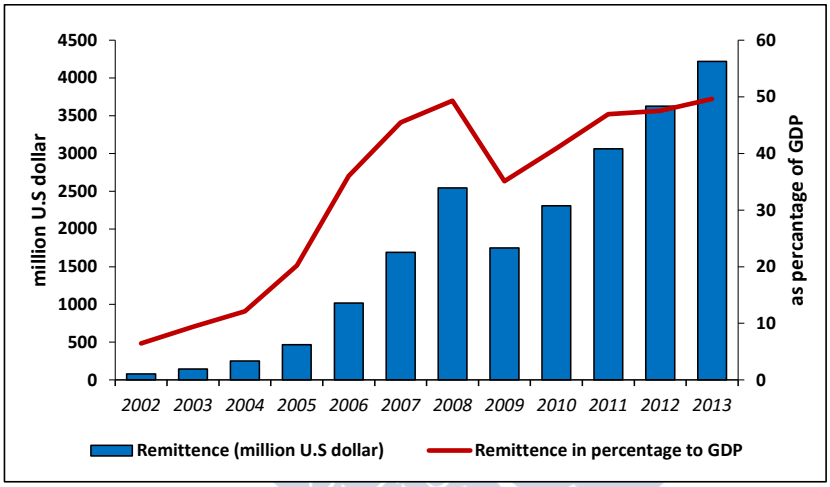
Tajik migrants have begun from hundred to thousand and rose up to millions, which now are equivalent to 18 percent of country's population. In Russia there are up to one million Tajik labor migrants (Brown et all, 2008). If the first migration outflow was occurred mainly by security concerns and political instability during the civil war, Being most of them skilled workers or so called "brain drain", the following years gave evidence that a large outflow of migrants from both rural and urban areas are unqualified workers. Migrants from Tajikistan usually work in sectors requiring a low-skilled labor force, such as construction, trade, utilities, therefore, in order to be a migrant worker a high level of

[100] In 2011 more than 60% of migrants were unemployed, comprising some 33 percent of workforce in overseas occupations and 27 percent working unofficially at home. Another smaller group (10.8%) was engaged in unpaid work in the household (Vinokurov et al, 2013).

education is not required. In some way, Tajikistan has a comparative advantage in the export of labor services, since the country is able to offer part of employable workers which can meet the demand for labor in Russia, (Vinokurov et al, 2013).

Accordingly, Tajikistan is one of the most remittance-dependent economies in the world. Labor migration and corresponding remittances from Tajikistan started in 2001 after signing EurAsEC agreement and from 2010 they grew so large that in 2013 remittances from migrant amounted to 45% country's GDP (Graph 4.11).

Graph 4.11. Migrant remittances, volume and as percentage of GDP



Source: Own elaboration from World Bank Database.

According to Vinokurov et al (2013), remittances from Tajik migrants play an essential role in the current stability of Tajikistan's external position not only in poverty alleviation but also in the conduct of GDP and unemployment, in trade flows, monetary policy and eventually in welfare. But, the dependence of Tajikistan on remittances from migrants working in Russia is a major source of macroeconomic vulnerability. The decline of the Russian economy, which employs more than 90% of migrants from Tajikistan, will have an adverse effect on revenues of migrant workers and will lead to a drop in demand and economic growth.

According to World Bank data, in 2011 the remittances amounted to $ 2.96 billion. Certainty, such growing remittances have significant relations with the increasing of trade flows, especially concerning imports. In fact, it stimulates the consumer domestic market

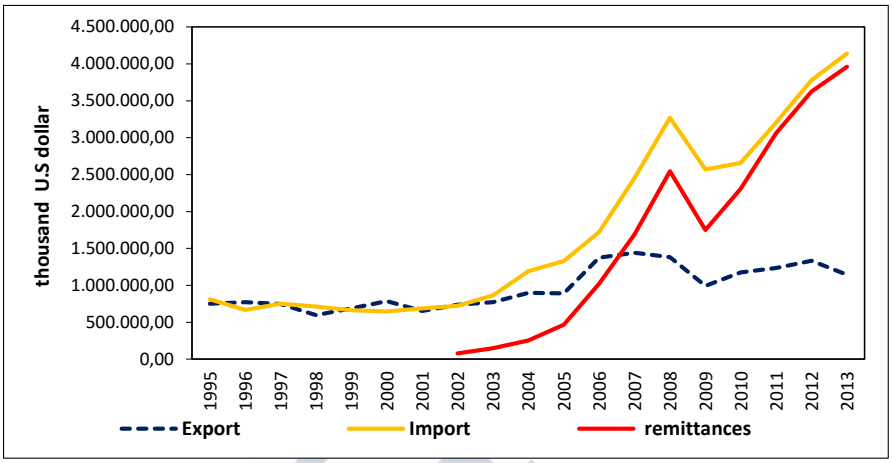
in which a large proportion of private consumption accounts for imported goods, including food, as well as it does induce the construction and manufacturing services.

Despite some noticeable Tajik governmental efforts towards migration movements were made such as opening up trade, establishing numerous commercial banking system, negotiating visa-free access for Tajik workers going to Russia, and removing taxes on remittance inflows, (World Bank, 2011), the migrant process still have many outstanding issues such as shortages of skilled labor and illegal migration that seems to be a major constraint to migrants law and remittances growth.

Estimates of the Eurasian Development Bank (2013) suggested that Tajikistan accession to the Eurasian Union and opening labor market will have a significant positive effect on the economy. Their policy recommendations include, on the first place, strengthening the existing system of professional training to improve the skills of migrants in the frame of legal migration. Secondly, there is the need to implement comprehensive measures to facilitate the flow of remittances at a higher level. Thirdly, the government policy of export labor resources should support the temporary labor migration, not the permanent one along with the attractive conditions for the return of migrants to their homeland. Moreover, active policies in the labor market of Tajikistan must be implemented in order to enhance the attractiveness of employment in the national economy, especially skilled workers within an extensive migration that will have a short-term positive effect on GDP growth and poverty reduction, but does not increase the potential for a long-term perspective.

A number of studies (Amir and Berry, 2012; Vinokurov et all, 2013) have argued that, on one hand, remittances are positively impacting home and host countries by providing large source of foreign currency, financing imports and promoting the balance of payment, resulting in the increased income but, on the other hand, this process has also a harmful side effect, which is an unhealthy and unstable growth of the economy with huge vulnerability results and severe social issues. In the case of Tajikistan, as was seen, remittances were important source of earnings, foreign exchange and imports growth (Graph 4.12). According to Khakimov (2014), the economic development of Tajikistan after 2004 was stimulated mainly by domestic demand growth, due to the large volume of labor migrant remittances.

Graph 4.12: Exports, Imports and Remittances of Tajikistan (US$ at current prices and current exchange rates)



Source: Own elaboration based on UNCTAD data

As is well-known, sustainable development implies ensuring stability for not only economic growth but also social development and ecological security. Rapidly growing remittances from hundreds of thousands of migrants to Russia has propped up the Tajik economy in recent years, but now the economic stresses are becoming increasingly apparent, (Amir and Berry, 2012). There are some specific issues about emigration/remittances related to their joint impacts on education, health and on child welfare in a more general sense. According to an estimation of Amir and Berry (2012), more than 9000 children whose parents have migrated are left without supervision, exposed to child labor and are deprived of being in school, although non-governmental and international organizations have made efforts to address this problem.

Of particular relevance, from an economic point of view, is the potential effect of income remittances on the exchange appreciation. In this sense, the IMF (2006) claims that remittances present important challenges for macroeconomic management because they impedes monetary management, raises inflation pressure, create a disincentive to domestic savings and contribute to the expansion of trade deficit. IMF (2008) shows for a group of 27 countries including Tajikistan that for the period 1990-2006, a 10% real depreciation is associated with a 1.2% of GDP trade balance improvement. After a calculation of a set of exchange rates, Khakimov (2014) finds that the Tajik Somoni (TJS) has appreciated during

the last years due to the steady inflow of remittances, which was an obstacle for the development of manufacturing and agriculture sectors.

Inflows of remittances lead to an increase of the demand for tradable and no-tradable goods. But, since prices of tradable goods are determined by the international market, only the prices of non-tradable goods (and services) rice. Then there is a shift of resources from tradable to non-tradable sectors and exports will be negatively affected because domestically produced goods become less competitive in domestic and international markets.

1.4.2.3. Protection for Industrial development

As mentioned previously, for developing countries, economic integration may be a form of industrialization policy and a tool for development (equivalent to other policies like import substitution and export expansion) (Sakamoto, 1969; Lizano and Willmore, 1975). So, Cooper and Massell, (1965b), have concluded that in evaluating the customs union effects on each member country not only the national income changes, but also the level and changes in size of industrial production must be taken into account. However, the positive benefits on industrial production from integration are unequally distributed between member countries: the greater gains are focused only in one or few member countries and for the economically weaker and geographically remote participating countries (like Tajikistan in the context of EurAsEC) this effect will be lower (Elkan, 1975).

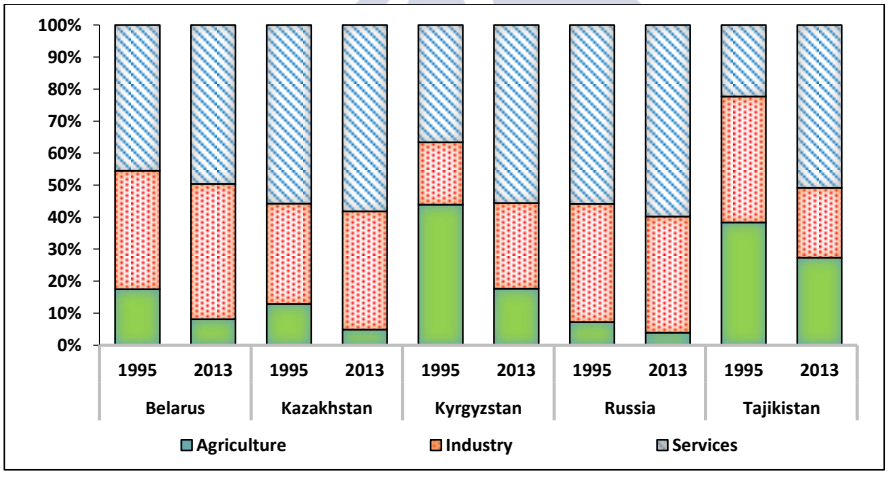
Since the Soviet Union time, Tajikistan has been an agricultural-industrial country. Favorable climate conditions, important water resource and cheap rural labor are incentives to agricultural activities, including cotton growing, the cultivation of crops, fruits, livestock products etc. In comparison with other transition economies, today Tajikistan is a highly agrarian country with nearly 74% of the population living in rural areas and about 66% occupied in this sector, agricultural activities account for 27.4% of the GDP in 2013 (World Bank, 2011). In addition, the agriculture branch is one of the potential spheres in terms of investment which can expect huge effects in the context of economic integration (Vinokurov et al, 2013).

The sectorial structure of Tajikistan's GDP has changed significantly over the period 1995-2013 (Graph 4.9). If in 1995 the share of agriculture in country's GDP

accounted for almost 40%, in 2013 this sector considerably decreased to 27,4%; however, the share in employment increase by seven percentage point (from 59.1% to 66.1%). In the case of the services sector, despite the low increase in the share of employment from 1995 to 2013 (Graph 7), the share of this sector in GDP increased from 22.3% to 50.8% in that period. By contrast, the participation of industry falls from 9.9% to 4.1% of total employment and from 39.3% to 21.8% in GDP.

All EurAsEC members shifted their sectoral patterns from agriculture to industry and service sectors. Tajikistan also did it in part, but it remains as an especial case: agriculture, although decreases, continues to have an important weight and the increased participation of the services sector in total output is at the expense of a decreased weight of the industry (Graph 11). While the Russian Federation, Belarus and Kazakhstan are relatively industrial economies, where industry accounts by 37%, 42%, 36% of GDP respectively, in Kyrgyzstan and Tajikistan, with 26% and 21% respectively, the industrial sector is very weak (Graph 4.13).

Graph 4.13: GDP sector contribution in EurAsEC countries, 1995-2013



Source: Own elaboration based on World Bank- WDI

The main reason behind the industrial downturn is the recent fall in cotton and aluminum prices (World Bank, 2011), which are products having an important role in industrial sphere (cotton fiber in the light industry and aluminum production in the heavy industry). The decrease in cotton prices on world markets was also a main responsible of shifting of agriculture sector in Tajikistan (Coulibaly, 2012), together with an increasing

demand for horticulture products in regional markets and an increasing productivity in that sub-sector. The contribution of livestock has also been increasing, although at a slower pace than non-cotton crops.

Although cotton remains important to the national economy, (accounts for 15 percent of Tajikistan's export revenues and 39 percent of total state tax revenue, providing to the government an incentive to ensure that it continues growing as a major crop), the structure of the cotton sector has been one of the biggest barriers to local investment in Tajikistan and has thereby contributed to migration in search of better opportunities in Russia (Amir and Berry, 2012).[101]

It is clear that the EurAsEC countries differ in terms of national sectorial structure. The existing structure, among which only Russia and Belarus can boast substantial manufacturing sectors, is an obstacle rather than an asset to integration of the EurAsEC countries. At this regard, (Golovnin, 2008) argued the main economic problem that EurAsEC must resolve is the structure of its member countries' economies. It has to be improved in order to increase the competitiveness of these individual countries (Kyrgyzstan and Tajikistan, in a larger extent, compete in low-value-added sectors) and that of the whole Community within the global economy.

These shared problems relate not just to the deterioration of the inherited structure of the economy but also to the need to create new and efficient sectors, for example, the financial sector. Banking systems and financial markets in EurAsEC countries, except for Russia and Kazakhstan, remain underdeveloped. Russia and Kazakhstan face large- scale outflow of capital, which is preventing their domestic financial markets from developing properly. The joint resolution of these problems may inform the new "agenda" of integration, actions like the implementation of a coordinated industrial policy and a system of compensation from the EurAsEC budget to mitigate the losses of member states and certain producers in the cases when shifting customs duties affect industries which are strategically important to a country's economy could work in that direction (Golovnin, 2008).

[101] Most migrant workers come from poor rural cotton-growing areas like Khatlon, which is the nation's largest cotton-growing province (with 60 percent of the total) and has far the highest level of extreme poverty (defined as per capita income of under US$1.05 per day). So, the reform of the cotton market in Tajikistan is critical to maximizing the developmental payoff to land reform (Amir and Berry, 2012).

Thus, taking into account the agricultural position of Tajikistan in the frame of EurAsEC, it seems that if the country develops its agriculture sector and specializes in its potential branch (namely cotton and fruits), it can get potential benefits from integration in terms of intensification of inter-industry trade with other EurAsEC members. However, from another angle, in such position, until Tajikistan successfully solve such problems as low productivity and industrial deterioration, it cannot protect its outdated industrial sector and it would be no competitive in external markets, especially in relation with most of the EurAsEC members. In addition, there is a huge gap concerning deterioration of the labor force quality due to an outflow of the most qualified staff from the country.

1.5. Trade-related determinants

The static effects and most of the dynamic effects of economic integration on welfare come from the changes that the integration processes cause in the trade flows and in the trade pattern in the participating countries. In the case of developing countries, there is determinants of the participation of these countries in integration processes which are related to trade but going beyond those traditional static and dynamic effects.

We start by showing the evolution of the trade trends and the trade structure (by sectors and partners) of Tajikistan and then we will focus on the found evidence on the considered trade-related determinants, namely, trade as a percentage of GDP, trade pattern with developed countries, intra-regional trade and total regional trade and competitive versus complementarity countries.

1.5.1. Trade trends and trade structure of Tajikistan

1.5.1.1. Trade trends

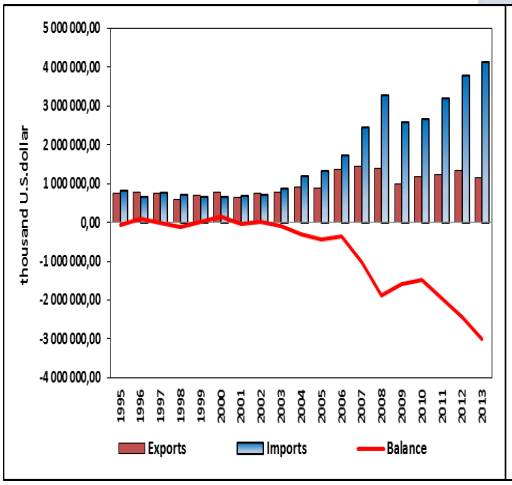
Since trade leads to a reduction in consumer prices, allows for the budget revenues necessary to maintain social infrastructure, increasing employment opportunities for key social groups, including women, thereby contributing to poverty reduction and social development in the country, according with the Ministry of Foreign Affairs of Tajikistan,

[102] the foreign trade, including regional trade, must play a central role in any realistic long-term strategies of the country's development. In fact, in the last two decades the foreign trade had a great importance for economic and social development of Tajikistan.

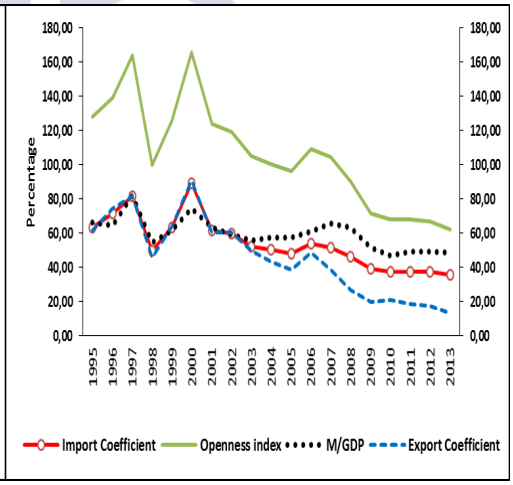
Tajikistan has been a member of WTO since March 2013 but the economy of Tajikistan was a fairly open economy before that. According to WTI data, the weighted mean applied tariff rate[103] decrease from 6.8% in 2002 to 5.6% in 2014 (for primary products the decrease was from 5.8% to 1.6%). As a consequence of this commercial policy, we observe a high openness index, increasingly explained by a high ratio of imports to GDP. Although total trade as a percentage of GDP (*openness index*) significantly decrease after 2000 is still over 60% (Graph 4.14b).

Between 1995 and 2000, exports and imports were almost at the same amount, being the trade balance nearly zero (Graph 4.14a). The growth rate of exports and imports in that period follow the path of GDP growth and export and import coefficients were practically the same, with values going from 90% to 45% (Graph 4.14b).

Graph 4.14 (a). Exports, imports and trade balance, 1995-2013 (Thousand US$)



Graph 4.14 (b). Export, Import and Openness coefficients, 1995-2013



Source: World Bank Indicators Data 2014 and UNCTAD

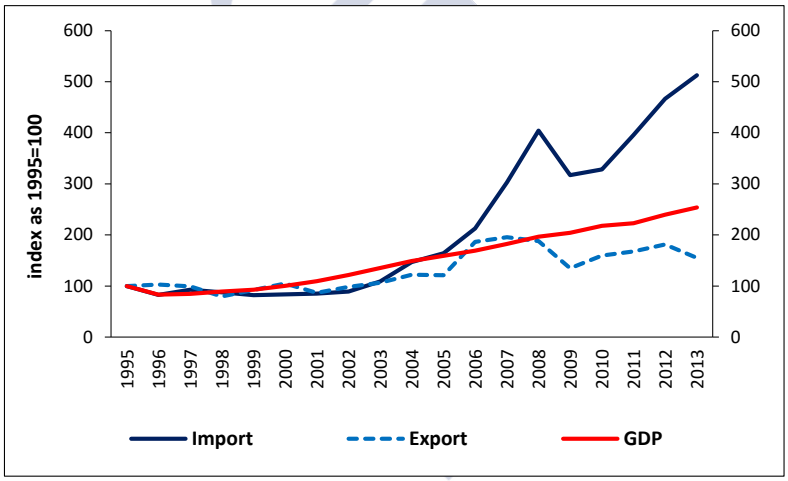
The situation starts changing after 2000. Although GDP shows high growth rates since 2000, imports as a percentage of GDP remains at high rates, going from 75% in 2000

[102] http://mfa.tj/en/economy/economic-development-of-the-republic-of-tajikistan.html

[103] It is the average of effectively applied rates weighted by the product import shares corresponding to each partner country.

to 49% in 2013. After 2000 (mainly after 2002) imports boom while exports show a very poor dynamic (Graph 4.15) and negative balance becomes higher and higher (Graph 4.14a). The percentage of GDP that is exported decreases dramatically after 2000 and the export coefficient falls from 91% to 13% over the period. Imports as a percentage of GDP were 66% in 1995 and, in spite of the high GDP growth rates over the period, were 49% of GDP in 2013 (graph 4.14b). As mentioned above, remittances (accounting by above 50% of GDP in 2013) explain this huge increase in imports. In general, remittances income imply an injection of resources into the economy, contributing to GDP, but imports being and increasing function of income become leakage (Raheem et al., 2014). This is especially relevant when, as it is the case of Tajikistan, imports consist essentially in consumption goods.

Graph 4.15: Exports, Imports and GDP of Tajikistan (index, 1995=100)



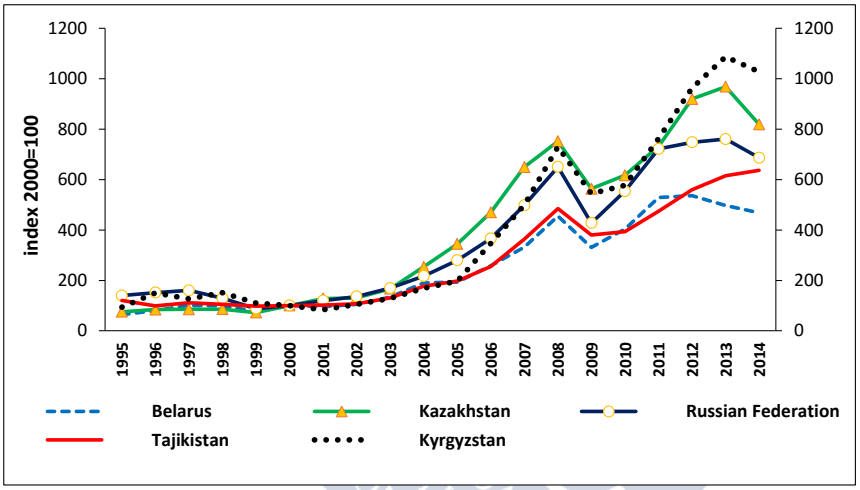
Source: Own elaboration base on UNCTAD Statistics data.

The foreign trade turnover of Tajikistan has generally increased in the period 1995-2013. According to UNCTAD data, in that period the export has increased 1.5 times, while imports grew 5.1 times (the official statistical agency of Tajikistan presents very similar figures, 1.8 and 4.8 respectively). However, it is noteworthy that these statistics do not take into account the volume of informal trade, which is really widespread in Tajikistan (Vinokurov et al, 2013).[104]

[104] Related with the special rules of transportation of goods across the border with a number of neighboring countries, the economy of Tajikistan has received important informal trade, and especially imports from

In the context of EurAsEC, Tajikistan exports and imports represents a very small proportion, but both variables had a very different evolution during the considered period. Imports evolution it was in line with the rest of the countries (Graph 4.16a) and its participation in total EurAsEC imports has been stable during the period, accounting for around 1.1%. By contrary, exports evolution was much less dynamic than for the rest of the countries so that its participation went from 0.64% in 2000 to 0.18% in 2013. So, the trade deficit almost tripled between 2007 and 2013.

Graph 4.16 (a): Imports of EurAsEC countries (index, 2000=100)



Source: Own elaboration base on UNCTAD Statistics data.

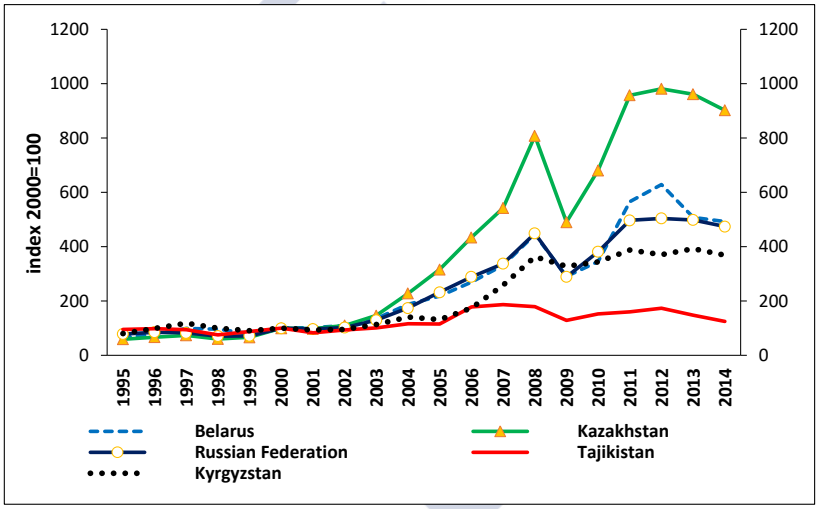
There are several reasons behind the export downturn. First of all, the lack of efficient domestically policy complicates trade management and economic development (World Bank, 2011). Second, since Tajikistan is heavily relying on exports of a few primary commodities, the recent fall in world cotton and aluminum prices explain part of the export reduction. Certainly, such situation makes the country vulnerable to the sharp price swings of these commodities in a time of volatile world market, resulting in the world crisis[105] that also had a relation with the rapid export decline. Thus, the trade deficit is

China, that is not reflected in official statistics. However, is a major source of cheap consumer goods for households of the republic and a source of income from re-exporting. In 2010 the volume of non-formal re-exports of Tajikistan amounted to about 70% of official exports. This external trade component is highly sensitive to policy changes and external shocks (Mogilevskii, 2012).

[105] Tajikistan's terms of trade severely worsened when world prices of cotton and aluminum (in 2007, cotton fiber and other cotton products accounted for 17 percent, and aluminum for 63 percent of total export) declined relative to those of imported food and fuel. Exacerbated by the global economic crisis that hit

really a reflection of the imbalance between domestic investment and domestic saving (Samuelson and Nordhaus, 2010). Although economy literature shows that deficit is not necessarily harmful, that is not the case for Tajikistan when we consider not just the volume of import but the composition of import (as we will see later); the Tajikistan imports are essentially for domestic consumption and not for investment and real growth. There is a strong positive relationship between export performance and economic growth (Bhagwati and Srinivasan, 1999), mainly when, as the result of exports, resources shift from low-productivity activities to the higher-productivity export products (Hausmann et al (2006). So, in the case of Tajikistan, during the considered period the contribution of exports to economic growth is very week.

Graph 4.16 (b) : Exports of EurAsEC countries (index, 2000=100)



Source: Own elaboration base on UNCTAD Statistics data.

1.5.1.2. Trade by sector

The structure of trade by products[106] shows that Tajikistan exports are dominated by raw materials such as non-precious metals, cotton, other agricultural products (vegetables, fruits) [107] and in the first half of the period also by energy products.

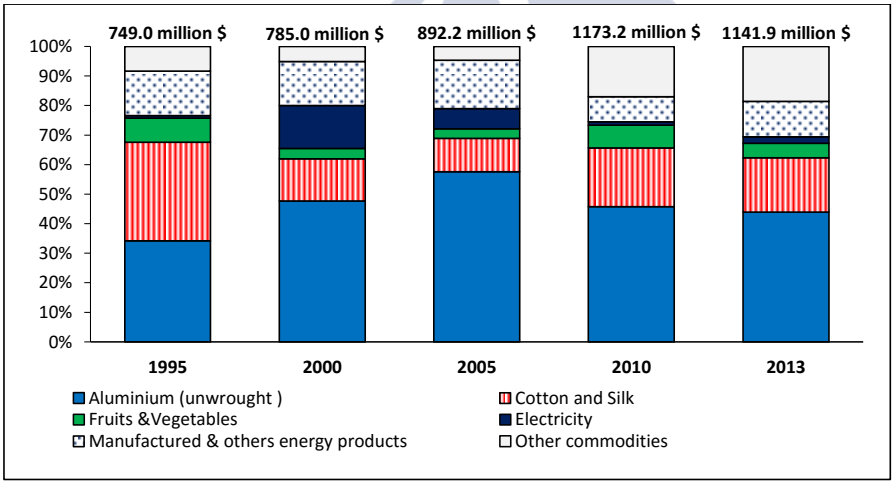
Tajikistan's trade partners in late 2008, aluminum export revenue fell by 46 percent and the value of cotton sales declined by 28 percent during the two years through end-2009 (World Bank, 2011).

[106] Data on trade by products are based on three digit level SITC Revision 3 commodity classification, expressed in thousands of dollars.

Among all of products, the main export product is unwrought aluminum (Graph 4.17) whose share from 2000 to 2013 in total exports decreased from 47.7% to 43.9% due to the fall in world price of aluminum as well as a high export concentration in this product. Cotton is the second major export product and, similarly, a decline in cotton share can be observed if we look into the whole period, but in comparison to 2006, the share of cotton exports has increased from 14.3% to 18.4% in 2013.

The high specialization of Tajikistan in cotton and aluminum production, which accounts for two-thirds of total exports, makes the Republic largely dependent on shocks like world prices for these export items. Electricity export had a significant stance in country's export profiles in some years (14.6% in 1999), but by 2013 it almost disappeared. The export market for this product is geographically very concentrated. Tajikistan exported electricity in those years just to Uzbekistan, due to the available infrastructure and good trade relation, but since one decade ago, Uzbekistan is no longer a main trade partner of Tajikistan neither for exports nor for imports.

Graph 4.17: Export of Tajikistan by group of products in the period 1995-2013



Source: Own elaboration based on data from UNCTAD Statistics www.unctad.org

[107] In agriculture, cotton is likely to remain an important source of exports, despite the recent decline in cultivated areas and exports. Gardening and related products may also have export potential. The main export markets for these products are likely to be China (which is quickly becoming an important export market for Tajik goods), other neighboring countries and Russia (Vinokurov et al, 2013). In addition, the World Bank (2011) suggested that Tajikistan will be able to develop the livestock sector, if will improve the process of feed storage and marketing of products of animal origin. Still the prospects of potential agricultural export sectors remain unimplemented due to excessive regulation and unpredictable intervention of the local authorities.

The high export concentration is not a new phenomenon for Tajikistan. Since the Soviet period, cotton and aluminum have been the leader products and in the last two decades they continue as the main products in the export profile of the country. One possible solution to this high export concentration would be to diversify the export basket through the development of another export potential as hydroelectric power or non-traditional export products.[108]

According to the World Bank report (World Bank, 2011), one of the most important comparative advantages in Tajikistan is hydropower, and it supposed that if appropriate conditions for implementing hydropower projects can be created, hydropower exports could be a new medium-term growth driver. The country has the potential to generate much higher hydropower than the domestic needs, which can be sold to the neighboring energy-deficient economies, particularly in South Asia and China. Tajikistan also has substantial reserves of coal that can be used as fuel for the production of thermal energy. It would be the most economical way to reduce the seasonal imbalance in the supply of energy as hydropower production is carried out in the summer months. It is also possible that the production of electricity in Tajikistan and in neighboring countries may be combined in order to export through the air line in the country with a deficit of energy. Two obstacles to the implementation of Tajikistan's hydropower potential: high capital costs for the construction of hydropower plants and associated transmission system (Vinokurov et al, 2013).

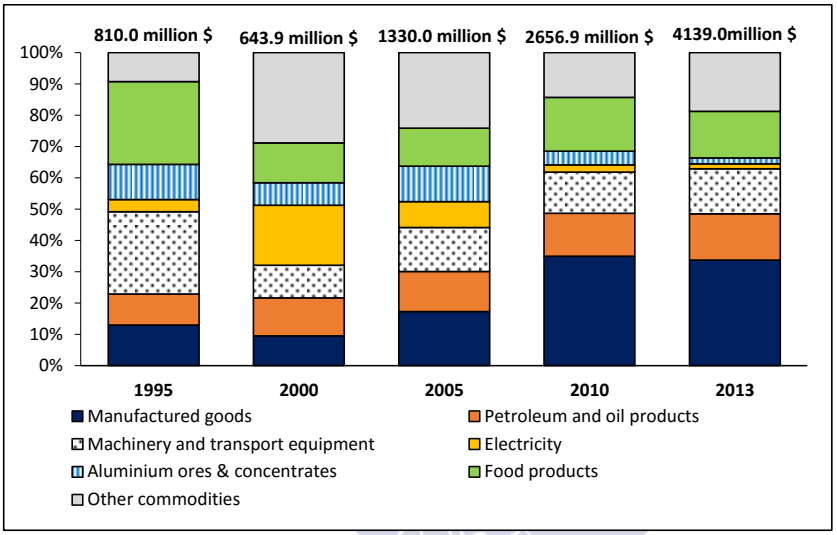
As far as import is concerned, the most noticeable products are minerals, especially alumina[109], consumer durables, food, machinery and petroleum and oil products (Graph 4.18). Imports of Tajikistan are much less concentrated than exports. The evidence shown in Graph 18 (in line with other studies like Mogilevsky, 2012; Coulibaly, 2012; Vinokurov et al, 2013) suggests that in Tajikistan, unlike other EurAsEC countries, there were huge changes in the structure of imports between 1995 and 2013. First, the share of alumina fell dramatically because of the low growth rate of aluminum exports, of which alumina is a

[108] It will be useful if this became essential agenda of the Tajikistan export policy. The non-traditional exports mean a shift of the export profile from the primary raw material to manufactured goods. This shift could be materialized for the Tajikistan economy largely due to an external trade and investment event in the context of an effective integration process.

[109] Alumina is used by the "Tajik Aluminum Company» (TALCO) as a raw material for the production of the most important strategic product (aluminum), almost 100% of which is directed for export (Vinokurov et al, 2013).

raw material. Second, there was a substantial decline in the imports of electricity and gas from Uzbekistan. Third, imports of machinery, metals, timber and oil products increased considerably reflecting an increase in public and private investments in the country in such areas as road rehabilitation, hydropower plant construction and housing construction. Petroleum and oil products, capital goods and intermediate products for these investment activities came primarily from Russia, China and Iran, which explains the increase in these countries' shares in total imports.

Graph 4.18: Imports of Tajikistan by group of products in the period 1995-2013



Source: UNCTAD Statistics – www.unctad.org

According to UNCTAD data (see Appendix 1), imports are less concentrated than exports and the concentration decreases over the period, showing a concentration index in 2013 very similar to Russia or Kazakhstan. The number of imported products has increased over the period and in 2013 it is also similar to that of the other countries of EurAsEC (228).[110] By contrary, the concentration index of exports has increased from 1995 to 2013, being in 2013 well above of that of other countries except Kazakhstan who focuses its exports on oil and gas. The number of exported products was virtually unchanged since the beginning of the period and is much lower than that for imported products and that for

[110] The product concentration index shows how exports and imports of a country are concentrated on a few products or otherwise distributed in a more homogeneous manner among a series of products. The diversification index indicates whether the structure of exports or imports by product of a given country differs from the world pattern. Number of products exported (or imported) at the three-digit SITC, Rev. 3 level.

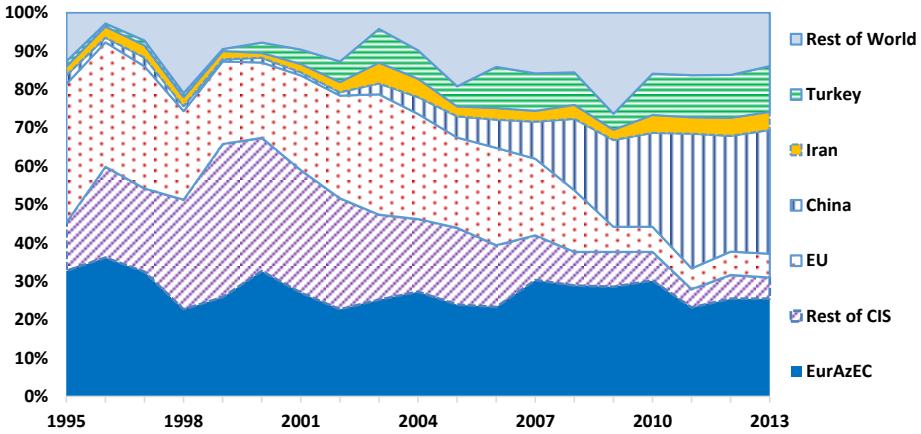
other countries. In addition, the structure of exports by product of Tajikistan differs from the pattern world more than for the other EurAsEC countries, while imports show a less dissimilar structure.

1.5.1.3. Trade by Partner

Currently the Republic of Tajikistan has trade relations with more than 100 countries and these relations have been enhanced from year to year. Recently, is quite observing that in Tajikistan the trend of interest to trade relation significantly has increased not only with developing countries like most of the Eurasian members (Belarus, Kazakhstan, Kyrgyzstan), but also with "semi" developed (or middle income) countries such as Russia, China, Turkey, Iran, etc.[111] or developed countries from the European Union.

Graph 19 shows the dynamic of the relative position of Tajikistan and its main trading partners: EU, China, Iran, Turkey, EurAsEC countries, CIS countries (other than EurAsEC) and the rest of the World. The dynamics of foreign trade turnover of Tajikistan with China, Turkey, and EurAsEC members in the recent years had a positive trend, while sharply decreased with EU and the CIS countries which are not members in EurAsEC.

Graph 4.19: The main foreign trade partners of Tajikistan in the period 1995-2013

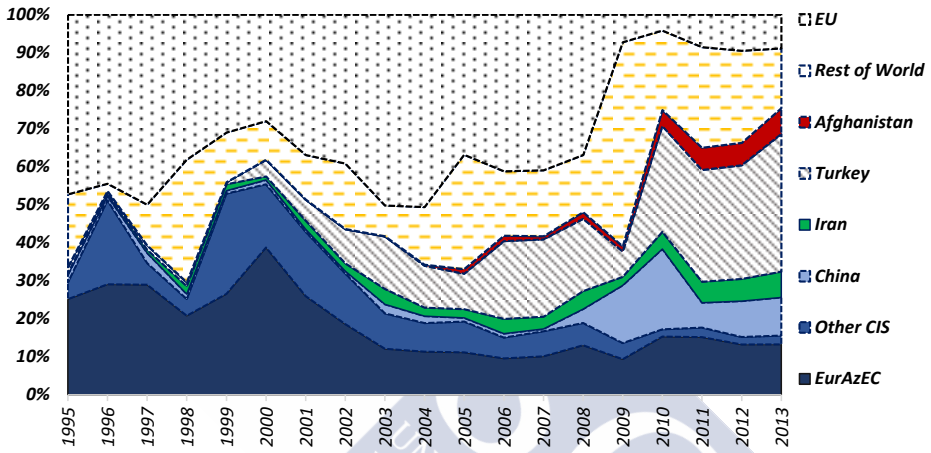


Source: UNCTAD, 2014 – www.unctad.org

[111] Although Russia, China, Turkey and Iran are not developed countries, they are neither a typical developing country. So in the view of Tajikistan as small undeveloped economy, in explaining trade with developed and developing countries, we can consider these countries as taking part of the developed ones.

In regard to exports (Graph 4.20), although Tajik commodity export pattern has not change significantly over the period 1995-2013, it showed substantial changes in partner structure. Perhaps the most interesting data from this figure is the decreasing of the export flow of Tajikistan with the EU and at the same time with CIS countries as well as with EurAsEC members.

Graph 4.20: Tajikistan's main foreign trade partner by export in the period 1995-2013

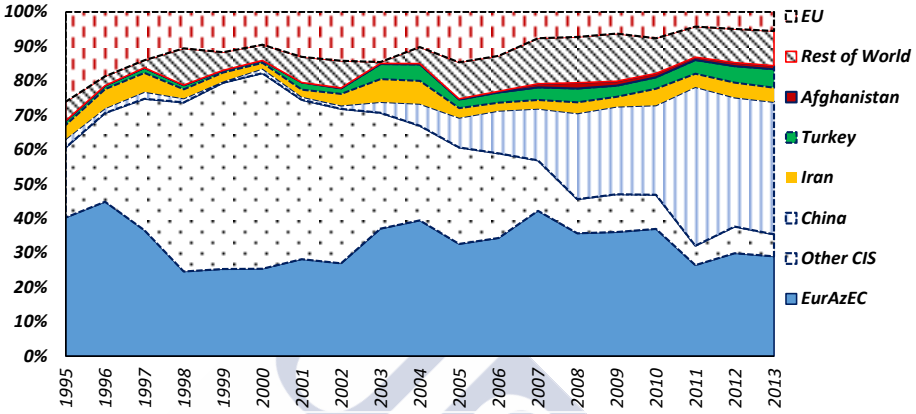


Source: UNCTAD, 2014 – www.unctad.org

The geographic dynamic of import inflows in the Tajikistan trade over the period 1995-2013 are shown in (Graph 4.21). From 1996 to 2007 Tajikistan had considerable import flows with the other CIS countries, which are not member of EurAsEC. If we exclude Russia and Kazakhstan it is quite clear that the majority of this import flow was only from Uzbekistan. The import decline with CIS countries was steeply from around 55% to around 11%. From one side, surely, it is an economic damage that the neighboring Uzbekistan has significantly reduced trade with Tajikistan. However, from another side, this sharp reduction caused geographical changing orientation and promoted the increase of import flows from China based on private consumption and capital goods. Thereby, the growing role of China can be the second notable feature of the Tajik imports performance by partners. The next feature is that among trade partners, after China the EurAsEC countries hold the largest share in the import structure. In fact, the two major members Russia and Kazakhstan (and in some extent Belarus and Kyrgyzstan) as the traditional and natural most important trade partners of Tajikistan retained their dominant position. In

regard to this, if we take into consideration the period before and after signing the agreement in 2000, the picture shows that the EurAsEC agreement has a positive effect on imports of Tajikistan, what was not the case for exports.

Graph 4.21: Tajikistan's main foreign trade partner by import in the period 1995-2013



Source: UNCTAD, 2014 – www.unctad.org

The first geographical origin of import flows of Tajikistan are China, EurAsEC and other neighbor countries. By products, mainly Tajikistan imports: petroleum products and foods, sugar (Ukraine, Russia, Kazakhstan, Iran); pharmaceuticals products, garments, machinery and equipment, building materials (Ukraine); clothing (China); flour and wheat (Kazakhstan). Uzbekistan being a member of the CIS and a main neighbor of Tajikistan is no longer a principal trade partner of the country neither in export nor in import. The difficult geographical location of Tajikistan favors trade with traditional post-Soviet partner and in parallel with regional powers such as the EU and China (Vinokurov et al, 2013).

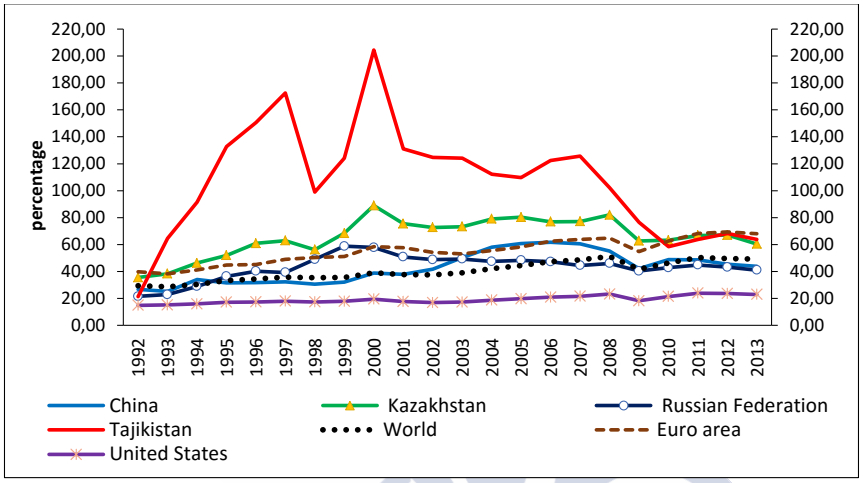
1.5.2. Integration determinants

1.5.2.1. Trade as a percentage of GDP

Countries are most likely to benefit from economic integration if they are closed economies, that is, if their volume of foreign trade as a percentage of their GDP is lower (Lipsey, 1960). In general, this factor is quite relevant for developing countries since the trade openness of these low-income countries has always been lower than that for high-

income countries.[112] However, (Hosny, 2013) has stressed that such observation does not apply to middle-income countries and least developed countries, both groups having higher trade openness level than that of the high-income group. This is the case of Tajikistan (Graph 4.20).

Graph 4.22: Openness index, selected countries, 1995-2013



Source: Own elaboration based on World Development Bank Indicators

So, the benefits associated to a more open economy is not working as a relevant integration determinant in the case of Tajikistan, explaining its desirability to enjoy EurAsEC beyond traditional static and dynamic effects. By 2000 Tajikistan was a highly open economy and the openness degree decreased from 2000 to 2013.

1.5.2.2. Change of the trade structure with developed countries

Since the major part of the import of developing countries from developed countries is capital goods (in the form of investment) and integration among these countries requires higher investments, the volume of imports of less integrating developed countries is likely to increase (Mikesell, 1965). So, the long-run target of integration among developing countries should not be decreasing trade with the rest of the world but

[112] The large countries in terms of GDP and/or population tend to trade less, as there is larger scope for trade within the country. Similarly, it has been argued that countries with high level of GDP per capita may also be biased toward having a lower level of trade to GDP ratio. The reason is that as countries develop, the share of the service sector tends to increase, and the service sector is largely non-tradable (Steven, 2005).

rather making changes in their trade structure. Also, taking into account the availability of foreign exchange as a determinant of imports in developing countries, Sakamoto (1969), claims that if a result of integration between developing countries a trade diversion in consumer goods takes place, this will release the larger foreign currency targeting at more imports of capital goods from third (developed) countries. Eventually, the volume of trade flows with the non-member countries may not change or may actually increase, but the most important thing is the changing of the trade structure.

In the case of Tajikistan integration in EurAsEC, part of these conditions are not met. There was not a trade diversion in consumer goods from the rest of the world to the integrated area, the consumer goods, consisting in the highest proportion of the imported goods, are imported mainly from China. Trade with the developed European countries has not increased over the period.

1.5.2.3. Intra-regional trade and total regional trade

Although Inotai (1991) shows that intra-regional trade and total regional trade indicators should not be the only ones considered in analyzing integration success when integration takes place between developing countries,[113] the increase of the share of intra-regional trade to total trade of the member countries remains as a relevant indicator. This is a useful indicator in determining not just the ex-post effects of a current step of an integration agreement, but the potential ex-ante effects derived from a deeper integration degree, as is the case of Tajikistan deciding to join new integration initiatives in the context of EurAsEC.

Since the collapse of the great Soviet Empire, resulting from the recession and the economic disintegration of an earlier common production system, trade and economic cooperation between EurAsEC countries dramatically shrank. One interpretation of the intra-regional relations reduction is given by disappearance of the majority of the enterprises and sectors in the transition period, especially manufacturing. Fortunately, this trend is not constant, by 2000-2005 after the transition period that was mostly over, the situation had started to change; in result, intra-trade between integrating members slightly increased once again (12%). However, historically, the republics of the former USSR were

[113] The joint industrial development, adequate infrastructure, and growing level of technology are also important targets and the growth of total regional trade can be assumed as positive only when it is combined with improvements in competitiveness in world markets.

much more integrated. In 1991 (the last year of the Soviet Union) intra-regional trade turnover was at 20% of their total trade turnover (Mogilevskii, 2012).

Although Eurasian Economic Community (EurAsEC) was the first and unique integration project in the scope of the post-Soviet Union supporting intra-regional trade initiatives that have applied zero tariffs for the majority of goods between countries, intra-regional trade is still a low proportion (Graph 21). In this integration group, progress in achieving the planned trade integration was limited because although there were elements of free trade between EurAsEC member states, exemptions and quotas were maintained and special trade measures were applied on a unilateral basis (Dragneva, 2012).[114]

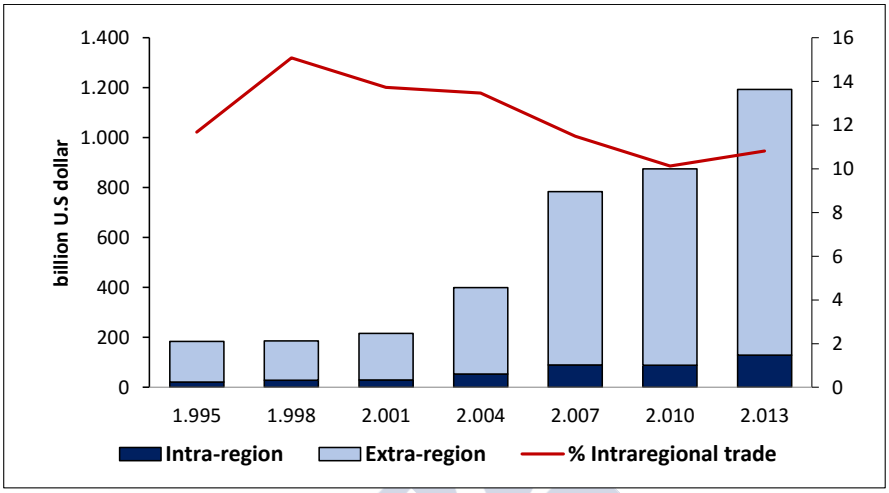
Total foreign trade of the integrating trade partners has an increasing annual tendency, except for 2009 which was characterized by a reduction in the volume of trade due to the financial crisis in most parts of the world. The coincidence of the creation of Customs Union in 2010 with the period of post-crisis recovery, largely complicates the analysis of the impact of the integration process. From 2001 to 2013 total intra-region turnover increased by 4.3 times (from 21.52 billion U.S dollars to 129.11 billion U.S dollars) but total trade of the region with the rest of the world increased by 5.7 times. Then, intra-regional trade share which was a small proportion in 2001 (13.7% of total trade) decreased over the period to 10.8% (Graph 4.23).

The lack of dynamic intra-regional trade in EurAsEC is largely defined by the nature of the goods traded within the region compared to those traded goods with third countries. Regarding to this, Golovnin (2008) brought a good example: machinery makes up a substantial share of trade within the bloc and price increases of these products are below the price of the fuel and energy sector. The low intra-regional trade in this area can be explained by different aspects. While the language is not a problem between these countries since they have a common one (Russian), logistic and bureaucracy issues make remarkable restrictions. Another interpretation is given by a drop in the global competitiveness of goods made in the EurAsEC compared to goods from third countries and the absence of significant changes in the structure of comparative advantage. In addition, the similarities in the structure of their economies and specifically the dominance of low-value added sectors (mining, agriculture and metallurgy) making the producers of

[114] Regarding with this Cooper (2013) notes, the expansion of the EU and WTO provided an impetus for Russia to engage in a 'competitive multilateralism', yet it ultimately continued to rely on bilateral relations, even within the common framework.

EurAsEC economies not complementary is another reason for the low level of intraregional trade (Golovnin, 2008).

Graph 4.23. Extra-regional and intra-regional trade turnover (billion USdollars) and share of intra-regional trade in total trade of EurAzEC



Source: UNCTAD DATA, 2014

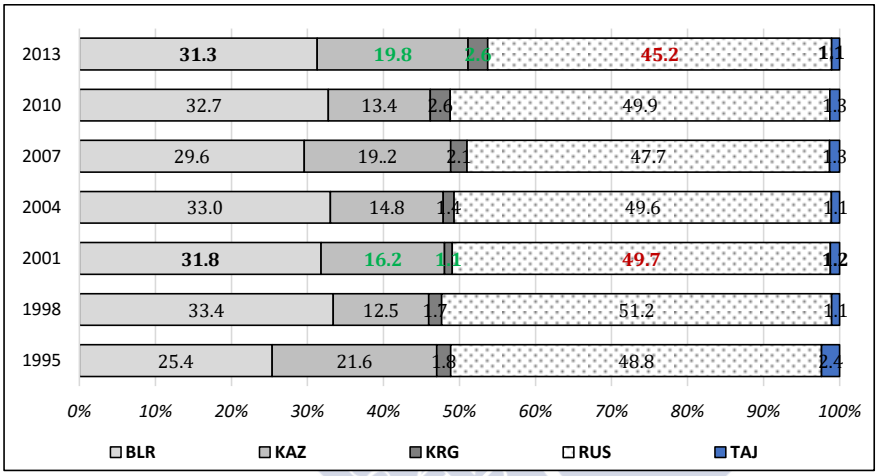
The insignificant trade within EurAsEC is characterized by the high reliance on one country market (Russia[115] and to a lesser extent Kazakhstan) (Graph 4.24), which makes the members of the regional association so vulnerable to the economic situation prevailing in Russia. It is also characterized by a lack of political commitment, for its high export commodity concentration, especially in primary raw trade, and for reduction of intra-industry trade (Tochitskaya et al 2008), as well as the intensity and the low complementarity index among member countries.

Another fundamental challenges related to the low share of intra-regional trade is transport costs (Kuzmina, 2012). The transportation component is so high for these states' exports to EurAsEC countries that even the duty free exports in many instances (agricultural products and mineral raw materials) cannot compensate heavy transportation

[115] This results in movements to raise barriers to intra-bloc trade and can lead to trade wars. Despite declarations that such barriers do not exist, in practice EurAsEC members (in particular, Russia and Belarus) have been waging trade wars more often, which have had a negative impact on trade and economic cooperation. Protracted debates between Russia and Belarus over conditions imposed on Belarusian sugar supplied to Russia and Kazakhstan's imposition of sugar import quotas are immediate examples to this matter. Protective measures do not only reduce trade but also undermine the basis of integration, creating barriers to foreign economic relations instead of removing them (Golovnin, 2008).

and transit expenses. Infrastructure barriers impede railing and shipping by internal waterways in communication with third countries having different rail gauge and navigation pass dimensions. Therefore, one of the main keys for successful and effective trade integration within EurAsEC is the modernization of their transport infrastructure that is now an "open agenda" of this regional project[116]. Certainly, such developments hold back the growth of intra-regional trade in this integration group compared to total foreign trade with the non-members.

Graph 4.24: Share in EurAsEC intra-regional trade by country, 1995-2013



Source: Own elaboration based on UNCTAD DATA

Russia has a much higher weight than the other EurAsEC countries in intra-regional (Graph 4.24) although from 2001 its share had decreased while the share of Kazakhstan and Kirghizstan increase. The participation of Belarus remains practically unchanged as well as that for Tajikistan, which represents only a negligible 1.1%. So, despite the trade orientation of the EurAsEC countries on the market of the rest of the world, Russia remains as an important trading partner for almost all members of the Community.

The high share of Russia in trade turnover of EurAsEC is just in comparison with the rest of members, but not in comparison with the total Russian foreign trade. Since

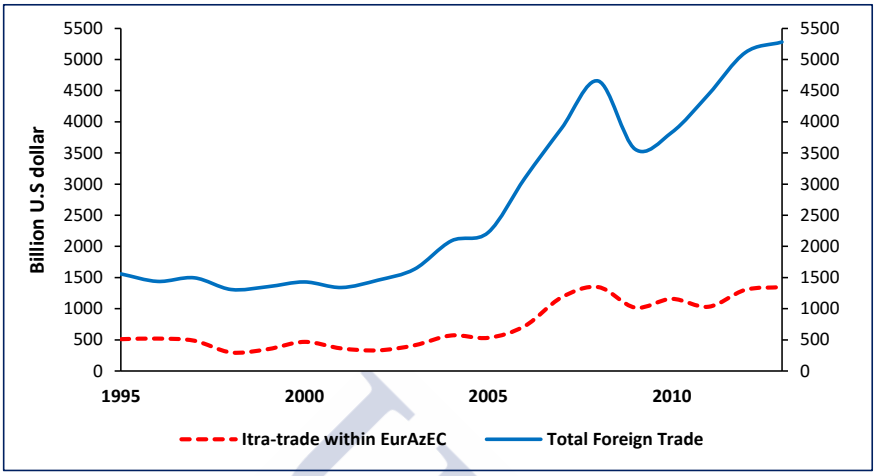
[116] A concept of Single Transport Space (STS) was approved early in 2008, which is correlated with the Customs Union becoming fully operational and is planned to be put in place by 2020. One of the major transportation system problems of these member states is high level (up to 70%) of deterioration of physical assets, as well as moral ageing of hauling stock of all types of transport. EurAsEC Interstate Council has approved an investment program aimed at renovation of roads and hauling stock. The Concept provides for implementation of 52 joint projects to build roads, bridges, logistical centers by 2020 (Kuzmina, 2012).

Russia is the engine of trade in the EurAsEC, the low share of EurAsEC trade in Russia's total foreign trade has also reduced intra-bloc trade in the area (Golovnin, 2008). Moreover, in the context of bilateral trade, although together with Russia, the role of Belarus and Kazakhstan was noticeable, the highest degree of bilateral trade can be observed only among some pair-countries headed by Russia - Belarus, followed by Russia – Kazakhstan, Tajikistan -Russia or Tajikistan- Kazakhstan.

In the case of Tajikistan, the share of intra-EurAsEC trade in total foreign trade is higher than for the total area but the increase in trade with EurAsEC after joining the agreement was not greater than for total trade, so that the share of intra-regional trade decreases from 27% in 2001 to 25.5% in 2013 (being much lower for exports than for imports, as we saw above). Further, after the project obtained "fast track" authority in 2006, intra-trade increased slightly more than total trade (186% and 171% respectively from 2006 to 2013).

Essentially, the poor development of intra-EurAsEC trade in the case of Tajikistan can be explained first by the high concentration index of the country's export in a few primary products (see Appendix 1); second, low complementarity indexes of the country's trade with the EurAsEC partners, mainly for exports, (see Tables 4.2 and 4.3 below) and finally, lack of political responsibilities. Despite these limits and the poor dynamic shown, intra-regional trade for Tajikistan remained important, chiefly with Russia in the context of oil and petrol products and Kazakhstan relating to wheat flour import, since these products are essential for Tajikistan economy. Moreover, while intra-regional trade is not significant for Tajikistan, it is quite important in some sector of its trade. For instance, a comparison of the commodity structure of imports indicates that trade in energy products (oil or petroleum), in agricultural products (other than cotton fiber), foodstuffs, manufactured products ("Machinery and equipment" and construction materials, fertilizers and other chemicals included into "Other products" category) occupies significant share in intra-regional trade.

Graph 4.25: Intra-regional trade of Tajikistan within EurAsEC and total foreign trade turnover (Million Dollars), 1995-2013



Source: Own elaboration based on UNCTAD DATA

1.5.2.4. Competitive Vs complementarity countries

The trade complementarity (TC) index, proposed by Michaely (1996), indicates to what extent countries are "natural trading partners", i.e., it measures at what extent the export (import) profile of a country j matches the import (export) profile of a country k. Then, this index of *trade compatibility* can give useful information on perspectives for trading partners that can motivate countries for participation into integration groups.

In general, two countries with a high TC index may gain from trade expansion following a preferential trade agreement more than two countries with a low TC index. So, the index can be particularly useful in an ex ante evaluation of the potential gains from bilateral or regional trade agreements, being an indicator of the relevance of a contemplated preferential agreement (Michaely, 1996).

The index matches only the demand of partners and does not include other trade determining factors such as distance of partners, the possibility of transport or trade barriers (Castro, 2010). At this regard, the WITS (2013) point that when countries are geographically distant, have a high transportation and transaction costs or the size

difference of two economies is large[117], a high complementarity index may not imply a gain from increased trade. The index may also suffer from aggregation bias.

The UNCTAD statistics present data for this index calculated as the sum of the absolute value of the difference between the import shares and the export shares (at 3-digit SITC, Revision 3 level) of the countries j and k and divided by two:[118]

$$TCmixj = 1 - \frac{\sum_k \left| m_{ki} - x_{kj} \right|}{2} \qquad TCximj = 1 - \frac{\sum_k \left| x_{ki} - m_{kj} \right|}{2}$$

Where, $\boldsymbol{TC}$m$\boldsymbol{i}$x$\boldsymbol{j}$ is the index of trade complementarity of importer country i with exporter country j; $\boldsymbol{TC}$x$\boldsymbol{i}$m$\boldsymbol{j}$ is the index of trade complementarity of exporter i and exporter j; $\boldsymbol{k}$ is goods in 3 digit SITC Revision 3; $\boldsymbol{mki}$ is the share of goods $\boldsymbol{k}$ in country i's total imports from the world; $\boldsymbol{xki}$ is the share of goods $\boldsymbol{k}$ in country j's total exports to the world.

The index value ranges between 0 and 1 (or 100 percent). Where 0 indicates that there is no matches at all between country j and country k export/import pattern (there is no god imported by one country which is exported by the other) and 1 indicates a perfect correlation in the export/import pattern (one country exports precisely what the other import).

The values of the index for Tajikistan as importer country and its main partners for the period 1995-2013 are shown in table 3. As partner countries, we take the EurAsEC as a whole, the EurAsEC countries (Belarus, Russia, Kazakhstan and Kirgizstan), Armenia, China, Iran Turkey and the European Union.

In 2000, when Tajikistan joint EurAsEC, the three exporting countries with which Tajikistan had highest TC index values were Kyrgyzstan, Belarus and Russia, all of them members of EurAsEC. In the three cases, values were higher in 2000 than in 1995. The EU, being a large economy, also shows a high and increasing index value in the different years. Taking Tajikistan as exporter country (table 4), TC index for of all main partners took very low levels in 2000, even lower than they were in 1995. The three countries showing highest index were Russia and Kazakhstan (from EurAsEC) and Turkey.

[117] A match in percentage terms does not imply a match in levels.
[118] Exports and imports are measured by commodity but they are relative to the world, not to each other.

Table 4.3: Trade complementarity index for Tajikistan (importer) with main trade partners, 1995-2013

EXPORTING / IMPORTING		ARM	BLR	CHN	IRN	KAZ	KRG	RUS	TUR	EU	EurAzEC
2000	**TJK**	0.16	**0.27**	0.17	0.11	0.14	**0.30**	**0.26**	0.21	0.24	0.22
2013	**TJK**	0.16	**0.40**	**0.41**	0.16	0.17	0.33	0.24	**0.51**	0.48	0.26

Source: Own elaboration based on data from UNCTAD, 2013
Note: TJK-Tajikistan, ARM-Armenia, BLR-Belarus, CHN-China, IRN-Iran, KAZ-Kazakhstan, KRG-Kyrgyzstan, RUS-Russia, TUR-Turkey, EU- European Union 28 countries.

Then, taking into account the qualitative information given by the TC index, by 2000 could reasonably be expected an expansion of trade after a preferential agreement with EurAsEC countries. We can see as the more and more diversified basket of imports of Tajikistan increasingly fits the export structure of its partners. By the contrary, the export structure of the country fits less with the import structure of all the main partners, since basket of exports of Tajikistan includes very few goods.

Table 4.4: Trade complementarity index for Tajikistan (exporter) with main trade partner, 1995-2013

MPORTING / EXPORTING		ARM	BLR	CHN	IRN	KAZ	KRG	RUSS	TUR	EU	EurAzEC
2000	**TJK**	0.09	0.09	0.09	0.07	**0.10**	0.09	**0.11**	**0.11**	0.10	0.09
2013	**TJK**	**0.12**	**0.11**	0.10	0.10	0.10	0.09	**0.13**	**0.11**	0.13	0.12

Source: Own elaboration based on data from UNCTAD, 2013
Note: TJK-Tajikistan, ARM-Armenia, BLR-Belarus, CHN-China, IRN-Iran, KAZ-Kazakhstan, KRG-Kyrgyzstan, RUS-Russia, TUR-Turkey, EU- European Union 28 countries.

By 2013 the situation had changed, especially in relating with TC index for Tajikistan imports. In general, index values are higher for all partner countries, also for EurAsEC countries with the exception of Russia. But the highest values are showed by Turkey and China, two non EurAsEC members (table 3). The huge increase in volume and diversity of Tajikistan imports from these main partner countries explain the change in index values. Regarding to TC index for Tajikistan exports, values remain low, much lower than those for imports, but they have increased for some countries, in particular for Iran, Armenia and Russia, the latter two being the countries showing highest values

followed by Belarus and Turkey. The index tends to be higher when the country is large (in terms of GDP), rich (in terms of per capita income); having a production pattern in which manufacturing is predominant and having diversified exports (Michaely, 1996). All these factors explain the low values of the index for Tajikistan.

From the index values in 2013, the recommendation in terms of the relevance of a deeper integration agreement with EurAsEC countries is not as clear as it could be in 2000, especially in regarding TC index for imports. According to Michaely (1996), a high coefficient would mean that a preferential agreement between an "importing" country and an "exporting" one would have a high likelihood of diverting imports of the former from the rest of the world to the exporting country. So, seen the coefficients for Tajikistan as a "exporting", is not expected that a preferential agreement with any of the considered partners diverts trade from the rest of the world to Tajikistan.

In relation with the low intra-regional trade of EurAsEC, Golovnin (2008), claims that one of the obstacles is the low and similar development level among a majority of them resulting in not having the option neither for inter-industry nor for intra-industry specialization.

1.6. Political determinants

As previously mentioned in the first and second chapters, in addition to economic factors there are a number of political determinants explaining the gains from integration and the desirability to enter into integration processes which are particularly relevant in the case of developing countries. So, Tajikistan looks at integration as the main engine of development not just for economic issues but also for political reasons and for the promotion of peace and security. Among the fundamental reasons of Tajikistan being member of EurAsEC are political and security reasons, since the most important military potency possesses only this project.

This partially explains the different integration initiatives followed. Indeed, given the geo-strategic position of Tajikistan, one of the main reasons of following several integration options is the political factor, since security issues have been predominant issues of economic development especially after the terrible civil war. While the interest of Tajikistan in joining international global organizations was a signal of nationhood (as a

member of UN) and potential financial support and assistance (as a member of the IMF and the World Bank), entering the WTO platform was aiming at searching a haven from the worst external events and strengthening its reputation in the world as well as creating favorable conditions for the attraction of foreign investment. The integration of Tajikistan with other group like the Islamic world and the regional integration with China are more in terms of security issues, in a generic sense, rather than economic goals. The principal objectives of these integration groups are the protection of the vital interests of the Muslims, the resolution of conflicts and disputes between Member States or even strengthening the mutual confidence, friendship and neighborship between member states, developing multi-profile of co-operation in order to maintain peace, security and stability in the region.

Moreover, sometimes, due to the lack of political will and the absence of consensus on who should lead the integration initiatives, the regional integration groups would be weakened making impossible any common action, allowing them to speak on more favorable conditions with outside factors. A good example can be the Central Asian integration concerning competition between Uzbekistan and Kazakhstan for the leadership in which no one could be the leader, resulting in the entry of Russia and China (Linn, 2012).

The reduction of illegal border migration is one of the desired political goals of many integration agreements between neighbor countries, especially when one of them is a developing country. Even if nowadays the right to visa-free for citizens of Tajikistan allows freely traveling to Russia, some of the migrants go through legal ways (registration, work permit or a patent) but others, for several reasons, do not abide by migration laws and they resort to illegal way. According to estimates of Vinokurov et al (2013), the share of illegal migrants is around 50-70% of the total number of migrants, which have many challenges that the accession of Tajikistan into the Customs Union can eliminate.

1.7. Conclusions

This chapter examined, firstly, the dynamic regional integration effects of EurAsEC for the economic growth of Tajikistan. Also in the context of the New Regionalism approach, the chapter analyzed some of the welfare effects of integration for developing

countries, which the traditional approach have not dealt with, as well as, some of the factors motivating developing countries to participate in an integration area, beyond traditional static and dynamic effects, that together with several political factors, could give rationality to the integration of Tajikistan into EurAsEC at two-stage, the current degree and possibly a deeper degree in the future.

Attracting Foreign Direct Investment (**FDI)**, as an essential component of the long-run dynamic effects on economic growth, is a major incentive for integration of developing countries. The increasingly interest of the Tajik government in development of the foreign investment climate, and growing importance of China, Russia, Iran, Kazakhstan, and International financial organizations as main investors in the several investment projects, suggest that Tajikistan has a very favorable potential investment conditions. Unfortunately, with the lack of transparent investment policies, poor business climate and a high level of corruption, Tajikistan lags with much smaller FDI, in relative terms, behind all the EurAsEC countries (EDB, 2013; FAO, 2014; UNCDAT, 2014; State Statistical Agency of Tajikistan and Investment Committee of Tajikistan). It is not surprising that corruption be the most highlighted reason for the low level of FDI in Tajikistan, since the country ranked very low in the Corruption Perceptions Index in 2014. In fact, the Bureau of economic and business affairs (2012) stated that until Tajikistan successfully struggles with such fundamental problems, it would not attract considerable foreign direct investment (FDI).

In spite of the poor performance of FDI, Tajikistan together with the other EurAsEC members enjoyed a faster **GDP growth** (averagely 7-8%) after 2000. In the case of Tajikistan, economic growth is explained in a large extent by high and increasing remittances (above 50% of GDP in 2013) and financial assistance from multilateral and bilateral development partners. Under those external environment factors, highly uncertain and domestic pressures growing, the authorities are confronted with the need to undertake a transition to a more sustainable and inclusive growth model (World Bank Group, 2015). Economic growth in Tajikistan, although unstable, is in the same line with the most EurAsEC countries in recent years, but **GDP per capita** of Tajikistan is negligible in comparison with these countries.

In the case of developing and less developed countries such as Tajikistan, the potential positive welfare effects of an integration process, explaining the desirability to these countries in participating in integration agreements go beyond the static effects and

dynamic. There are several economic and political integration determinants that could give rationality to the Tajik decision about join EurAsEC in spite of low or ambiguous static and dynamic effects. Following Marinov (2014), we have considered in this chapter three categories of integration determinants: general economic (development objective), market-related, and trade-related determinants.

Among the stated objectives for an integration agreement, the **economic development objective** is the most important one for developing countries. In this regard, **poverty alleviation** was identified as one of the major development objectives standing in the way of Tajik government. Poverty rate fell from 79.8 percent in 2000 to 32 percent in 2014 of people living under poverty line (Taj Stat, 2015). The main determinants of that reduction are: the participation of Tajikistan in International organizations with the special aim of poverty alleviation, the growing volume of international remittances, agricultural production by private household plots and collective household farmers and the social assistance through organizations helping people in an extreme poverty situation are the main. Certainly, Tajikistan has done a remarkable job in reducing poverty with more than a million people moving out of the poor zone. However, with a poverty rate of 32% in 2013, the country is still recognized as a poorest country in the scope of EurAsEC.

Starting from a relatively high **Human Development Index (HDI)** from the Soviet era, after the collapse of the USSR Tajikistan HDI fallen sharply from 0.629 in 1991 to 0.535 in 2000 and only the country could catch up the previous rate in 2014. Currently, Tajikistan still has a lower HDI than the other EurAsEC countries, (UNDP, 2015).

In regard the market-related determinants, we have focused on the potential effects of integration on employment and productivity and the industry development. Despite of the high economic growth in the country, **employment** growth was not observed, neither in the large sectors such as services and industry nor in the small construction sector. Only the agricultural sector provided new jobs, accounting by 66% of total employment in 2013. In a context of increasing population, the **unemployment** rate increased. Although according to the Taj Stat, the registered unemployment rate in the country is around 2.5 percent over the period, the official number of unemployed is far from reality (Avezedo et al, 2014). ILO estimates an unemployment rate four times larger (11.5% in 2009), which is the highest of the EurAsEC area. Thus, it seems that the positive effects of integration on the labor market were not observed in terms of employment.

Given the increase in the share of employment in the agricultural sector, the increase of the economy's **productivity** depends on the increase in productivity in agriculture. Despite some increase in the valued added by worker in sector in recent years, the agriculture productivity in Tajikistan is still in the lowest position within the region.

In a context of unemployment and household poverty, migration is the solution for many people in Tajikistan. In fact, around 15% of total population has migrated, mainly to Russia. Consequently, Tajikistan with a volume of remittances accounting by 50% of GDP in 2013 is one of the most remittance-dependent economies in the world (Vinokurov et al, 2013). The huge amount of remittances, which contributed positively to the poverty alleviation and labor market pressure, is also a source of macroeconomic instability by its contribution to, among other aspects, the exchange rate appreciation and the increase in the trade deficit.

After present the evolution of the Tajikistan trade trends and trade structure (by sectors and partners) in the chapter we considered the followed trade-related determinants: trade as a percentage of GDP, trade pattern with developed countries, intra-regional trade and total regional trade and competitive versus complementarity countries.

After the war-time recession, the **foreign trade turnover of Tajikistan** came out with a positive dynamics, increasing between 1995 and 2013. From 1995 to 2000, exports and imports were almost at the same amount, being the trade balance nearly zero. However, in the last decade Tajik export and import significantly differs by size. Over that period, the export has increased 1.5 times whereas imports rose 5.1 times. In the early 2000, import as a percentage of GDP amounted to 75%, a decade after, the level of import remains high, around 49% of GDP in 2013, despite a substantial GDP growth observed. By contrary, in 2013 the share of export in country's GDP was significantly smaller, around 13%, which dramatically fell from 91% in 2000 following the decline in the world price of cotton and aluminum as main export products.

Regard to trade by partners, Tajikistan export and import are increasing not only with EurAsEC members but also and a larger extent with non-EurAsEC countries such as China, Iran, and Turkey. However, trade flows with other non-member countries like the EU and CIS countries shows a negative trend. Thus, in spite of substantial extra-regional trade turnover (1.064 billion U.S dollars), the intra-regional trade remains highly insignificant (129 billion U. S dollars) representing only 10% of total EurAzEC trade in

2013. In the case of Tajikistan, the proportion of intra-EurAsEC trade in total foreign trade is higher than for the area as a whole. However, the intra-regional proportion in total foreign trade decreases from 27% in 2001 to 25.5% in 2013.

We cannot conclude that the effects of integration on **trade openness** or **trade pattern with developed countries** are determinant of the desirability of Tajikistan to join EurAsEC. By 2000, Tajikistan was a highly open economy and the openness degree fell from 2000 to 2013. Moreover, the trade flows of Tajikistan with the developed European countries have not increased over the period. The higher import share consisting of consumer goods come namely from China.

The **trade complementarity (TC) index** that indicates to what extent the export (import) profile of a country j matches the import (export) profile of a country k, shows much lower values for Tajikistan as an exporter than as an importer. In both of the cases, the index increased from 2000 to 2013 not just with EurAsEC members but also and in a larger extent with some other countries like Turkey and China. Thus, while by 2000 could reasonably be expected an expansion of trade after a preferential agreement with EurAsEC countries, from the index values in 2013 the recommendation in terms of the relevance of a deeper integration agreement with EurAsEC countries is not as clear, especially in regarding TC index for imports.

Among the several integration options followed by Tajikistan over the past two decades (as it was showed in chapter two), it seems that in recent years it is giving priority to integration in EurAsEC, which has recently moved towards a greater degree of integration by forming an Economic Union three member countries (Russia, Belarus and Kazakhstan). In the eve of Tajikistan' accession into the EurAsEC-Customs Union, the relevance of potential effects from integration for Tajikistan became a more decisive issue, especially in view of the existing political and economic backwardness.

Tajikistan, a small landlocked country with a geostrategic mountainous terrain, relative remoteness and communication isolation from the existing global transport infrastructure as well as numerous other transition challenges, confronted immediately after independence in 1991 a terrible civil war. This brought to the poorest country of the Former Soviet-Union to a deeper level of poverty, vandalism, and low pace of development in human capital and, of course, damaged infrastructure. Ensuring that regional economic integration succeeds in Tajikistan is vital, not only because of the

previously mentioned challenges but also because of the policies that could ensure successful integration for a country that together with its neighbors has many elements of transboundary nature (water and energy, transport and the potential of Islamic Resistance) which inevitably require an "integrated" answer.

Chapter three has shown that the welfare effects of the EurAsEC agreement through static trade creation and trade diversion effects (in the context of the *Traditional Theory of Economic Integration*) are positive for Tajikistan although of a moderate amount. As it was seen in chapter one, the *New Theory Economic Integration* claims that the most important effects of integration processes are dynamic effects in terms of large-scale economies, technological change, effects on marker structure and competition, productivity growth and investment activity. In essence, dynamic effects of economic integration are defined as anything that affects the country's rate of economic growth over the medium term, (Schiff and Winters, 1998, p. 179). Although the dynamic effects are the most relevant, mainly for developing countries, the literature of economic integration dealing with developing and least developed countries, as it is the case for Tajikistan, has generally recognized that for such type of countries neither the “New” nor, mainly, the “traditional" economic integration theory are adequate. So, in the frame of the new economic integration theory, an extensive literature focus on the potential effects of integration to developing countries and the motivation of these countries to participate in integration processes beyond the static and dynamic effects, (Meier, 1960; Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al, 1969; Abdel Jaber, 1971; Robson, 1980; Mackay, 1984; De Melo, 2011; Hosny, 2013; Marinov, 2014).

At this regard, regional integration in Tajikistan is essential, expecting that it will help in enhancing development of not only because the static effects of resource allocation (as the traditional theory claims) but also enhanced economic growth and development objectives through creation of common projects such as poverty alleviation, improving standard and quality of life by promoting health and education issues, productive employment, services and coordination of foreign policy aiming at peace and security within and between the regions.

Thus, this chapter analyzes, on the one hand, the **dynamic effects** of EurAsEC for economic growth of Tajikistan and, on the other hand, also in the context of the New Regionalism, some of the **welfare effects of integration for developing countries** that are

not covered by traditional analysis for developed countries, as well as some of the **factors motivating developing countries to participate in an integration area** that could give rationality to integration of Tajikistan into EurAsEC at both the current degree and perhaps a deeper degree in the future. Following Marinov (2014), the potential effects and factors which are relevant for developing countries, constituting the economic determinants of integration that influence the motivation of these countries to participate in integration agreements are organized into three categories: general economic (development objective), market-related, and trade-related determinants. In addition to economic determinants, there are also several political incentives of economic integration that are of special importance to developing countries.

In the context of **dynamic effects**, economic integration by attracting foreign direct investment (FDI) may affects aggregate productivity in the economy through technology transfer and increased competition and, then, positively affects the economic growth rate.

In Tajikistan, FDI has been dominated by investors such as Russia, China, Iran, Kazakhstan, and International financial organizations like the World Bank. The vast priority areas of FDI opportunities are directed, firstly, to the hydroelectric power, mining sector (primary aluminum) and agriculture development, especially, deep processing of cotton fibers and, secondly, to the banking sector, service industry, tourism and manufacture of construction materials. But, the lack of a national strategy for FDI promotion and transparent investment policies hinders the capacity of Tajik government to attract foreign investment (EDB, 2013; FAO, 2014; UNCDAT, 2014; State Statistical Agency of Tajikistan and Investment Committee of Tajikistan). According to the Bureau of economic and business affairs (2012), Tajikistan looks mostly after state-led investment and external loans from the country's perceived geopolitical friends rather than making conditions favorable to private investors from abroad.

Thus, Tajikistan, in line with most of the EurAsEC countries, showed a faster GDP growth averagely 7-8% between 1995 and 2013. However, despite the relatively stable macroeconomic indicators, Tajikistan's economy remains dependent on external factors which are a major source of vulnerability (World Bank, 2011). Two external factors deserve particular attention: the contribution of remittances (mainly from Russia) to Tajikistan's growth since 2004 (50% of GDP in 2013) and the fact that economic growth

was mostly supported by development assistance from multilateral and bilateral development partners.

The economic growth of Tajikistan is very similar to EurAsEC countries, but country's GDP per capita is still significantly below all the EurAsEC members (GDP per capita in Tajikistan was only 7.2% of that of Russia in 2013) and nearly 35 percent population still lives under the absolute poverty line. In spite of weak static and dynamic traditional effects, as a developing country, there are several economic and political determinants which can give rationality to the decision of Tajikistan join EurAsEC.

Among the economic determinants to integration, beyond the traditional static and dynamic effects, one of the most relevant for developing countries is the **economic development objective**. Poverty reduction was one of the fundamental and primary development objectives of Tajik government. After a period of political imbalance and gradually recuperation, the economy of Tajikistan has showed rapid growth that helped to significantly decline the level of poverty that fell from over 80 percent to about 32 percent during the period 1999-2014. Remittances played a crucial role on poverty reduction, especially in rural areas (Azevedo et all, 2014). Nevertheless, despite high poverty alleviation, Tajikistan is still one of the poorest countries in the region in terms of per capita income.

The situation was similar in terms of other development indicators. In the beginning of the 90s, Tajikistan along with most of the post-Soviet countries had relatively high Human Development Index, reflecting the heritage of economic and social development achieved during the Soviet empire. However, with the disintegration result and civil war, its HDI has fallen sharply from 0.629 in 1991 to 0.535 in 2000. The decline in the HDI during this time indicates that the relative position of life expectancy, education and GDP per capita in Tajikistan has been deteriorated. Although recent dates show that Tajikistan's HDI value again increased up 0.624, putting the country in the medium category ranking (129 out of 188 countries), country's HDI is still behind the other EurAsEC countries, (UNDP, 2015).

Among the market-related determinants, of particular importance are the potential effects on **employment and productivity** and the **industry development** induced by integration. Tajikistan was unable to create enough jobs for a growing population and the unemployment rate remains the highest in the region. The jobs created are mainly in

agriculture, which accounts for over 66% of total employment. Although productivity in the agricultural sector has increased in recent years, it remains far below that of other countries in the region. The answer to unemployment and poverty, especially in rural areas and by young people, has been migration. Tajik migrants abroad (mainly in Russia) are equivalent to 18% of country population. Consequently, remittances from migrant grown enormously since 2000, amounted to 45% country's GDP in 2013. Migrant remittances were a main driver of economic growth and development, with a positive effect on poverty alleviation and unemployment reduction, but the high dependence of Tajikistan on remittances from migrants (90% of them in Russia) and the effect of remittances on exchange rate are also a source of macroeconomic vulnerability.

Regarding the development of the industrial sector, the success of the integration process is highly doubtful, it is an outdated and deteriorated sector with low productivity. The participation of the industry has fall from 39.3% to 21.8% of total GDP and from 9.9% to 4.1% of total employment, mainly due to the recent fall in cotton and aluminum prices (World Bank, 2011).

After show the evolution of the trade trends and the trade structure (by sectors and partners) of Tajikistan, we present the found evidence on several **trade-related determinants** which are relevant in the case of developing countries, namely, trade as a percentage of GDP, trade pattern with developed countries, intra-regional trade and total regional trade and competitive versus complementarity countries.

The foreign trade turnover of Tajikistan has generally increased in the period 1995-2013. According to UNCTAD data, over the period the export has increased 1.5 times, while imports grew 5.1 times. From 2000 to 2013 imports boom (mainly after 2002) while exports show a very poor dynamic and negative trade balance becomes higher and higher. The percentage of GDP that is exported decrease dramatically after 2000 and the export coefficient falls from 91% to 13% over the period. Imports as a percentage of GDP accounted by 75% in 2000 and, in spite of the high GDP growth rates over the period, they accounted by 49% of GDP in 2013. Remittances (accounting by above 50% of GDP in 2013) explain this huge increase in imports.

In the context of EurAsEC, Tajikistan exports and imports represents a very small proportion, showing both variables a different evolution from 2000 to 2013. Imports evolution it was in line with the rest of the countries remaining its participation in total

EurAsEC imports by around 1.1%. By contrary, exports evolution was much less dynamic than for the rest of the countries so that its participation falls from 0.64% in 2000 to 0.18% in 2013.

The high concentration of Tajikistan exports in unwrought aluminum and cotton, which accounts for two-thirds of total exports, makes the Republic largely dependent on shocks like world prices. Imports are less concentrated than exports and, by contrary to exports, the concentration decreases over the period, showing a concentration index in 2013 very similar to Russia or Kazakhstan. The main partners of Tajikistan in recent years are China, Turkey and EurAsEC members (with which the dynamics of foreign trade turnover of Tajikistan with in the recent years had a positive trend); and EU and the CIS countries which are not members in EurAsEC (with which trade decreased with).

The increase of **the share of intra-regional** trade to total trade and the **increase of total trade** are common accepted indicators of integration agreement successful, although Inotai (1991) shows that these indicators should not be the only ones considered in analyzing integration successful when integration takes place between developing countries. In the case of Tajikistan, the share of intra-EurAsEC trade in total foreign trade is higher than for the total area but the increase in trade with EurAsEC after join the agreement was not greater than for total trade, so that the share of intra-regional trade decreases from 27% in 2001 to 25.5% in 2013.

Trade as a percentage of GDP and **trade pattern with developed countries** are not relevant integration determinants in the case of Tajikistan explaining its desirability to enjoy EurAsEC beyond traditional static and dynamic effects. On the one hand, by 2000 Tajikistan was a highly open economy and the openness degree decrease from 2000 to 2013. On the other hand, trade flows of Tajikistan with the developed European countries has not increased over the period and the greater proportion of imported goods, consisting in consumer goods, are imported mainly from China.

Trade **complementarity indexes** show that the increasingly diversified basket of imports of Tajikistan increasingly fits the export structure of its partners. By the contrary, the export structure of the country fits less with the import structure of all the main partners, since exports basket of Tajikistan includes very few goods. Taking into account the qualitative information given by the TC index, by 2000 could reasonably be expected an expansion of trade after a preferential agreement with EurAsEC countries since the

highest TC index values were shown for EurAsEC countries. However, from the index values in 2013, the relevance of a deeper integration agreement with EurAsEC countries is not as clear, especially in regarding TC index for imports.

After the introduction, the rest of this chapter is organized as follows. Section two will gives an overview of Tajikistan. Section three focuses on the dynamic effects for the economic growth rate of Tajikistan into the context of EurAsEC. Section four analyses the potential dynamic effects of EurAsEC to Tajikistan and several economic integration economic integration determinants as a developing country, in an attempt to determine the rationality of Tajikistan joining EurAsEC beyond the traditional static and dynamic effects. Finally, section five will draw some conclusions.

Appendix 4.1: Number of Products and export concentration and diversification indices[119] by countries of EurAzEC, 1995-2013

	Belarus			Kazakhstan			Kyrgyzstan			Russia			Tajikistan		
	NP	*CI*	*DI*	*NP*	*CI*	*DI*	*NP*	*CI*	*DI*	*NP*	*CI*	*DI*	*NP*	*CI*	*DI*
1995	215	0.49	0.70	206	0.20	0.73	147	0.14	0.69	251	0.26	0.67	109	0.44	0.78
1996	225	0.10	0.48	218	0.23	0.73	157	0.17	0.71	251	0.26	0.67	100	0.42	0.78
1997	228	0.10	0.48	203	0.27	0.77	160	0.20	0.69	249	0.26	0.67	97	0.44	0.80
1998	228	0.10	0.48	189	0.29	0.82	141	0.34	0.73	254	0.22	0.68	77	0.40	0.83
1999	223	0.11	0.50	184	0.38	0.82	135	0.26	0.74	245	0.26	0.68	90	0.44	0.83
2000	225	0.17	0.55	188	0.48	0.82	136	0.33	0.77	246	0.28	0.65	82	0.49	0.84
2001	222	0.15	0.54	182	0.48	0.81	120	0.34	0.75	249	0.29	0.65	80	0.51	0.84
2002	220	0.17	0.52	179	0.50	0.81	126	0.23	0.71	249	0.30	0.66	82	0.54	0.84
2003	223	0.17	0.52	193	0.52	0.79	136	0.27	0.70	250	0.31	0.67	75	0.51	0.81
2004	222	0.21	0.54	200	0.55	0.78	141	0.29	0.72	250	0.32	0.66	84	0.47	0.83
2005	214	0.28	0.57	195	0.61	0.76	142	0.24	0.72	248	0.35	0.66	72	0.57	0.84
2006	214	0.31	0.58	199	0.60	0.75	158	0.17	0.70	249	0.35	0.65	84	0.70	0.88
2007	213	0.29	0.58	195	0.57	0.74	172	0.20	0.71	250	0.35	0.64	86	0.67	0.87
2008	219	0.31	0.59	210	0.59	0.74	178	0.27	0.73	248	0.36	0.62	106	0.58	0.86
2009	210	0.30	0.58	211	0.59	0.77	175	0.26	0.73	250	0.35	0.64	107	0.28	0.81
2010	220	0.25	0.54	211	0.63	0.76	180	0.16	0.68	247	0.37	0.65	99	0.47	0.81
2011	228	0.29	0.57	223	0.61	0.75	184	0.15	0.65	250	0.38	0.64	114	0.48	0.79
2012	224	0.29	0.59	230	0.59	0.73	179	0.15	0.57	254	0.38	0.61	113	0.54	0.87
2013	228	0.25	0.53	225	0.65	0.74	202	0.15	0.64	253	0.43	0.60	119	0.48	0.85

Source: Own elaboration based on data from UNCTAD

[119] The diversification index (DI) indicates whether the structure of exports or imports by product of a given country differs from the world pattern. The product concentration index (CI) shows how exports and imports of a country are concentrated on a few products or otherwise distributed in a more homogeneous manner among a series of products. NP: Number of products exported (or imported) at the three-digit SITC, Rev. 3 level.

Appendix 4.2: Number of products and Import concentration and diversification indices by countries of EurAzEC, 1995-2013

	Belarus			Kazakhstan			Kyrgyzstan			Russia			Tajikistan		
	NP	*CI*	*DI*	*NP*	*CI*	*DI*	*NP*	*CI*	*DI*	*NP*	*CI*	*DI*	*NP*	*CI*	*DI*
1995	234	0.50	0.60	237	0.09	0.48	159	0.20	0.58	257	0.21	0.46	177	0.14	0.58
1996	241	0.10	0.38	246	0.07	0.44	171	0.16	0.56	258	0.04	0.38	173	0.15	0.61
1997	242	0.10	0.38	240	0.08	0.44	199	0.12	0.50	257	0.05	0.38	177	0.15	0.62
1998	242	0.10	0.39	243	0.07	0.41	205	0.12	0.51	257	0.04	0.36	169	0.21	0.69
1999	240	0.10	0.39	236	0.07	0.43	194	0.10	0.49	256	0.04	0.36	163	0.24	0.72
2000	250	0.16	0.42	242	0.06	0.41	197	0.12	0.48	257	0.04	0.35	151	0.24	0.71
2001	247	0.15	0.44	241	0.07	0.39	190	0.13	0.50	256	0.05	0.34	172	0.24	0.68
2002	240	0.15	0.42	241	0.07	0.37	192	0.13	0.54	256	0.05	0.33	178	0.22	0.66
2003	240	0.15	0.40	242	0.06	0.35	199	0.15	0.51	257	0.05	0.31	189	0.17	0.52
2004	241	0.17	0.40	244	0.07	0.37	200	0.18	0.53	257	0.06	0.32	191	0.15	0.50
2005	243	0.23	0.42	248	0.07	0.36	213	0.20	0.53	256	0.06	0.34	208	0.16	0.58
2006	241	0.22	0.38	247	0.07	0.35	206	0.21	0.52	256	0.07	0.34	203	0.15	0.52
2007	242	0.22	0.38	250	0.07	0.35	219	0.22	0.51	257	0.08	0.34	217	0.11	0.51
2008	244	0.21	0.33	248	0.08	0.37	217	0.32	0.54	257	0.09	0.36	225	0.09	0.52
2009	244	0.23	0.36	248	0.09	0.39	217	0.24	0.53	256	0.05	0.31	219	0.08	0.50
2010	244	0.19	0.38	248	0.10	0.40	217	0.20	0.49	256	0.06	0.33	222	0.10	0.52
2011	245	0.21	0.37	252	0.10	0.37	225	0.17	0.44	258	0.06	0.34	224	0.09	0.51
2012	245	0.19	0.34	252	0.07	0.35	225	0.16	0.49	259	0.07	0.35	227	0.09	0.55
2013	246	0.17	0.34	253	0.07	0.34	233	0.18	0.48	258	0.06	0.34	228	0.09	0.54

Source: Own elaboration based on data from UNCTAD

General Conclusions

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General Conclusions

The main research objective of the thesis was the evaluation of the integration process followed by Tajikistan after independence and the expected effects of the EurAsEC regional agreement on Tajikistan.

Once URSS was disintegrated, after several years of civil war and with a seriously weakened economy, Tajikistan tries to inset itself into de regional and the global economy being the main objective the economic growth and development. Chapter two has shown that the integration process followed by Tajikistan basically followed three strategies: regional agreements with ex-soviet countries, regional agreements with other neighborhood countries (in particular with Islamic countries and with China), and agreements with international institutions and organizations (looking for financial support and assistance). According to several studies, the most significant regional agreement involving Tajikistan, having better prospects for the future, is the Eurasian Economic Community (EurAsEC), formed in 2000 (Pomfret, 2004; Dragneva and Wolczuk, 2012; Kuzmina, 2012; Libman and Vinokurov, 2012; Cooper, 2013; Kembayev, 2014; Galiakberov and Abdullin, 2014; Yesdauletova, 2014). It seem clear that in recent years this agreement is the most active one, in particular after moving towards a greater degree of integration by forming an Economic Union three member countries (Russia, Belarus and Kazakhstan)[120] and that Tajikistan is giving priority to this initiative.

Before analyzing the effects of the EurAsEC economic integration agreement on Tajikistan, we have reviewed in chapter one the literature on economic integration. After show the meaning of economic integration and the ways how economic integration takes place, we reviewed the literature on the potential welfare effects of economic integration, in particular for developing countries. These effects rationally explain the desire of countries in participate in integration agreements.

The conclusion is that the "orthodox theory of Viner-Meade-Lipsey" with their traditional restrictive approach is not appropriate to the case of developing countries, since it may not always correspond with their economic development objectives (Meier, 1960;

[120] Eurasian Economic Integration has arrived at just the right time. The Asia-Europe economic region is undergoing major changes. With the strengthening of the Chinese economy and the crisis with the euro, the economic balance is shifting. Meanwhile, question about the future of the economies in the post - Soviet region are arising. The new order now being attempted under Russians leadership could take on considerably more significance (Henning Schröder, 2013).

Balassa, 1965; Abdel Jaber, 1971; Mackay, 1984). In the context of the "New Regionalism", we reached the outcome that special accent should be put on potential dynamic effects in analyzing the effects of economic integration of developing countries and the motivation of these countries to participate in integration processes (Mikesell, 1965; Sakamoto, 1969; Abdel Jaber, 1971; Rueda-Junquera, 2006). We have found an extensive literature addressing on the potential effects of integration to developing countries claiming that the rationale behind economic integration cannot be defined in terms of static or "traditional" effects, but also the dynamic effects or "New" analysis has to be carried out carefully, concluding that the motivation of these countries to participate in integration processes go beyond the static and dynamic effects and other integration determinants should be taken into account (Meier, 1960; Allen, 1961; Brown, 1961; Cooper and Massell, 1965b; Kahnert et al, 1969; Abdel Jaber, 1971; Robson, 1980; Mackay, 1984; De Melo, 2011; Hosny, 2013; Marinov, 2014).

Once the theoretical review was addressed, our interest turned to the empirical identification of economic integration effects of the EurAsEC agreement for Tajikistan. In chapter three, in the context of the traditional static economic integration effects, we analyzed the trade creation and trade diversion effects of EurAsEC as a whole and, in particular, for Tajikistan. We can conclude that EurAsEC had a positive net trade creation effect and, therefore, a positive welfare effect.

Results show that the gravity model explains well intra-regional trade in the case of EurAsEC. In general, the traditional variables of the gravity model explaining the "normal" trade are significant and have the expected signs: intra-regional trade flows between EurAsEC members are positively related to GDP of the reporter country (as importer or as exporter) and variables representing aspects facilitating trade like share a common border or a language, and negatively related to distance. Partner's country GDP has a positive effect on intra-regional exports but a negative effect on intra-regional imports. Real exchange rate has the expected negative effect on intra-EurAsEC imports and for intra-regional exports the sign of the coefficient is positive but this variable is not significant.

With regard to the effects of the preferential agreement, the coefficients of the regional dummy variables show unambiguously that EurAsEC generated a net trade creation effect. Membership in EurAsEC had significant effects on bilateral trade within the area, mainly in terms of imports, without generate trade diversion from the rest of the

world. Imports from and exports to the no-EurAsEC partners also were positively affected but to a lesser extent than intra-regional flows.

Results for Tajikistan trade flows show that imports are positively related to Tajikistan's GDP and exports are positively related to partner countries GDP. Sharing a language positively affects both imports and exports. Moreover, exports are positively affected by sharing a border and negatively affected by distance; however, both variables are not significant in explaining imports. Membership of EurAsEC positively affects Tajikistan trade flows, to a much larger extent on imports than on exports but in both cases to a larger extent than on total EurAsEC trade flows.

In the case of Tajikistan, imports greatly increased after join EurAsEC, both from the area and from other partners outside the area. However, exports have showed a very poor performance, generating a huge trade deficit. Nevertheless, the export performance has not been so bad with EurAsEC partners than with some of the non-member which was traditionally important partners, namely the European Union. Therefore, in the context of EurAsEC, intensifying relations with member countries and reducing costs of transporting goods to these countries seem to be good recommendations. But Tajikistan should not concentrate its commercial policy efforts only on these partners. There are more dynamic neighboring economies outside EurAsEC, namely Turkey and China, which also should be stated objectives for the Tajikistan exports.

Since "New" economic integration theory claims that in the case of developing countries, special accent should be put on potential dynamic effects, in chapter four our research interests turn to the analysis of the dynamic effects of EurAsEC on Tajikistan. Firstly, we have analyzed the growth effects which are mainly influenced by investment and especially by FDI. We also show evidence on several integration factors influencing the desirability of developing countries to participate in regional integration agreements.

Although substantial work has been done for fulfilling investment programs and attracting **FDI** projects were observed in some years, the investment development has not made notable progress in Tajikistan. In spite of the poor performance of FDI, Tajikistan together with the other EurAsEC members enjoyed a faster **GDP growth** (averagely 7-8%) after 2000. In the case of Tajikistan, economic growth is explained in a large extent by high and increasing remittances and financial assistance from multilateral and bilateral development partners. Under those external environment factors, highly uncertain and

domestic pressures growing, the authorities are confronted with the need to undertake a transition to a more sustainable and inclusive growth model (World Bank Group, 2015). Economic growth in Tajikistan, although unstable, is in the same line with the most EurAsEC countries in recent years, but **GDP per capita** of Tajikistan is negligible in comparison with these countries. So, it seems that dynamic effects appear weak in the case of Tajikistan.

As a developing country, there are several **economic and political integration determinants** that could give rationality to the Tajik decision about join EurAsEC in spite of low or ambiguous static and dynamic effects.

The **economic development objective** is the most important of the integration objectives for developing countries. P**overty alleviation** was identified as one of the major development objectives standing in the way of Tajik government. Poverty rate fell from 79.8 percent in 2000 to 32 percent in 2014 of people living under poverty line (Taj Stat, 2015). Certainly, Tajikistan has done a remarkable job in reducing poverty with more than a million people moving out of the poor zone. However, with a poverty rate of 32% in 2013, the country is still recognized as a poorest country in the scope of EurAsEC.

Starting from a relatively **high Human Development Index (HDI)** from the Soviet era, after the collapse of the USSR Tajikistan HDI fallen sharply from 0.629 in 1991 to 0.535 in 2000 and only the country could catch up the previous rate in 2014. Currently, Tajikistan still has a lower HDI than the other EurAsEC countries, (UNDP, 2015).

In regard the market-related determinants, we have focused on the potential effects of integration on employment and productivity and the industry development. Despite of the high economic growth in the country, **employment** growth was not observed, neither in the large sectors such as services and industry nor in the small construction sector. Only the agricultural sector provided new jobs, accounting by 66% of total employment in 2013. In a context of increasing population, the **unemployment** rate increased. ILO estimates unemployment rate of 11.5% in 2009, which is the highest of the EurAsEC area. Thus, it seems that the positive effects of integration on the labor market were not observed in terms of employment.

Given the increase in the share of employment in the agricultural sector, the increase of the economy's **productivity** depends on the increase in productivity in

agriculture. Despite some increase in the valued added by worker in sector in recent years, the agriculture productivity in Tajikistan is still in the lowest position within the region.

In a context of unemployment and household poverty, migration is the solution for many people in Tajikistan. In fact, around 15% of total population has migrated, mainly to Russia. Consequently, Tajikistan with a volume of remittances accounting by 50% of GDP in 2013 is one of the most remittance-dependent economies in the world (Vinokurov et al, 2013). The huge amount of remittances, which contributed positively to the poverty alleviation and labor market pressure, is also a source of macroeconomic instability by its contribution to, among other aspects, the exchange rate appreciation and the increase in the trade deficit.

In regard trade-related determinants, we have analyzed trade as a percentage of GDP, trade pattern with developed countries, intra-regional trade and total regional trade and competitive versus complementarity countries.

After the war-time recession, the **foreign trade turnover of Tajikistan** came out with a positive dynamics, increasing between 1995 and 2013. From 1995 to 2000 the trade balance was nearly zero. However, in the last decade Tajik export has increased 1.5 times whereas imports rose 5.1 times. In the early 2000, import as a percentage of GDP amounted to 75%, a decade after, the level of import remains high, around 49% of GDP in 2013, despite a substantial GDP growth observed. By contrary, in 2013 the share of export in country's GDP was significantly smaller, around 13%, which dramatically fell from 91% in 2000 following the decline in the world price of cotton and aluminum as main export products.

Regard to trade by partners, Tajikistan export and import increase not only with EurAsEC members but also and a larger extent with non-EurAsEC countries such as China, Iran, and Turkey. However, trade flows with other non-member countries like the EU and CIS countries shows a negative trend. Thus, in spite of substantial extra-regional trade turnover, the intra-regional trade remains highly insignificant, representing only 10% of total EurAzEC trade in 2013. In the case of Tajikistan, the proportion of intra-EurAsEC trade in total foreign trade is higher than for the area as a whole. However, the intra-regional proportion in total foreign trade decreases from 27% in 2001 to 25.5% in 2013.

The effects of integration on **trade openness** or **trade pattern with developed countries** are not determinants of the desirability of Tajikistan to join EurAsEC. By 2000,

Tajikistan was a highly open economy and the openness degree fell from 2000 to 2013. Moreover, the trade flows of Tajikistan with the developed European countries have not increased over the period. The higher import share consisting of consumer goods come namely from China.

The **trade complementarity (TC) index** that indicates to what extent the export (import) profile of a country j matches the import (export) profile of a country k, shows much lower values for Tajikistan as an exporter than as an importer. In both of the cases, the index increased from 2000 to 2013 not just with EurAsEC members but also and in a larger extent with some other countries like Turkey and China. Thus, while by 2000 could reasonably be expected an expansion of trade after a preferential agreement with EurAsEC countries, from the index values in 2013 the relevance of a deeper integration with EurAsEC is not as clear, especially in regarding TC index for imports.

The main objective of this work was to analyze the effects of EurAsEC on Tajikistan, trying to justify the rationality for the participation of Tajikistan in this project at the current stage and to potentially continue in the future with a greater integration degree. The overall conclusion is that while the results, although most of them positive, are of small size, EurAsEC under the leadership of Russia, is surely the most interesting alternative among the possible regional integration options.

While, from the point of view of potential economic relations, it would be of interest a closer integration with countries outside the ex-soviética orbit, in particular China and Turkey, the interest from a general socio-economic perspective and the viability of those initiatives in the medium and long terms are doubtful.

First, Tajikistan remains heavily dependent on Russia, which although it is a source of instability is not waivable in the short and medium terms. Russia, that explicitly tries by all means to keep leadership in the region and has a final objective of recomposing somehow what was the Soviet space, will not support any initiative that excludes it or in what his leadership is questioned.

In the current geopolitical context, deepen integration with the Islamic world through agreements involving Turkey but also Iran, Pakistan and Afghanistan, although in principle appear to meet security objectives, it is not the best way to ensure the economic and social stability of the country. On the other hand, enhance integration with China through the Shanghai agreement, it seems clearly interesting, but surely Russia, which is

also a member of this organization, will not support the development of this agreement, which actually leads China, rather than EurAsEC where clearly its leadership is not discussed.

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Resumen

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Resumen

El objetivo principal de la tesis es el análisis del proceso de integración seguido por Tayikistán después de la independencia y los efectos esperados del acuerdo de integración regional EurAsEC sobre Tayikistán.

Tras la desintegración de la URSS, después de varios años de guerra civil y con una economía seriamente debilitada, Tayikistán trata de integrarse en la economía regional y mundial, teniendo como principal objetivo el crecimiento económico y el desarrollo. El capítulo dos muestra que el proceso de integración seguido por Tayikistán se basó fundamentalmente en tres estrategias: acuerdos regionales con los países ex-soviéticos, acuerdos regionales con otros países vecinos (en particular con países islámicos y con China), y acuerdos con instituciones y organizaciones internacionales (buscando asistencia y apoyo financiero).

Según varios estudios, el acuerdo regional más importante en el que está implicado Tayikistán, y el que tiene mejores perspectivas para el futuro, es la Comunidad Económica Euroasiática (EurAsEC), formada en el año 2000 (Pomfret, 2004; Dragneva y Wolczuk, 2012; Kuzmina, 2012; Libman y Vinokurov 2012; Cooper, 2013; Kembayev, 2014; Galiakberov y Abdullin, 2014; Yesdauletova, 2014). Parece claro que en los últimos años este acuerdo es el más activo, en particular después de avanzar hacia un mayor grado de integración tras la formación de una unión económica por parte de tres países miembros (Rusia, Bielorrusia y Kazajstán), y que Tayikistán está dando prioridad a esta iniciativa.

Antes de analizar empíricamente los efectos del acuerdo de integración económica EurAsEC sobre Tayikistán, en el capítulo uno se revisa la literatura sobre integración económica. Después de mostrar el significado de la integración económica y las formas en las que un proceso de integración económica se lleva a cabo, tanto con una *integración negativa* (eliminando barreras) como con una *positiva* (creando nuevas instituciones y coordinando políticas), se abordan los posibles efectos de la integración para el bienestar, en particular para los países en desarrollo. Estos efectos son los que dan racionalidad a la decisión de los países de participar en acuerdos de integración regional.

En cuanto al análisis de los efectos de la integración para el bienestar, nos centramos tanto en los efectos estáticos contemplados por la *Teoría Tradicional de la integración* como en los efectos dinámicos en los que se centra la *Nueva Teoría de la integración*. La conclusión es que la "teoría ortodoxa de Viner-Meade-Lipsey" con su

tradicional enfoque restrictivo no es apropiado para el caso de los países en desarrollo, ya que no siempre sus objetivos con los de desarrollo económico (Meier, 1960; Balassa, 1965; Abdel Jaber, 1971; Mackay, 1984). En el contexto del "nuevo regionalismo", llegamos al resultado de que cuando se trata de analizar los efectos de la integración para países en desarrollo y de entender la motivación de estos países para participar en procesos de integración, el acento se debe poner en los posibles efectos dinámicos que influencian el crecimiento económico a medio y largo plazo (Mikesell, 1965; Sakamoto, 1969; Abdel Jaber, 1971; Rueda-Junquera, 2006). Además, hemos encontrado una extensa literatura que trata sobre los efectos potenciales de la integración para los países en desarrollo, afirmando que la motivación de estos países para participar en los procesos de integración va más allá de los efectos estáticos y dinámicos, siendo necesario considerar otros factores determinantes de la integración (Meier, 1960; Allen, 1961; Brown, 1961; Cooper y Massell, 1965b; Kahnert et al, 1969; Abdel Jaber, 1971; Robson, 1980; Mackay, 1984; De Melo, 2011; Hosny, 2013; Marinov, 2014).

Una vez llevada a cabo la revisión de la literatura sobre integración económica y mostrada la pauta de integración seguida por Tayikistán, concluyendo que el acuerdo más relevante en el que participa el país es EurAsEC, nuestro interés se dirige a la identificación empírica de los efectos de la integración en EurAsEC para Tayikistán. En el capítulo tres, en el contexto de los tradicionales *efectos estáticos* de la integración económica, analizamos los efectos de *creación* y *desvío* de comercio, tanto para EurAsEC en su conjunto como, en particular, para Tayikistán, estimando, con datos de panel, un Modelo Gravitacional aumentado, en el que además de las variables habituales se incluyeron variables dummy regionales que permiten concluir la existencia de creación y desvío de comercio. El modelo fue testado para una muestra de 26 países para el periodo 1995-2013. La conclusión general es que EurAsEC tuvo un efecto neto positivo de creación de comercio y, por tanto, un efecto positivo sobre el bienestar.

Los resultados muestran que el modelo gavitacional explica bien el comercio intra-regional en el caso de EurAsEC. En general, las variables tradicionales del modelo que explican el comercio "normal" son significativas y tienen los signos esperados: los flujos de comercio intra-regional entre los miembros de EurAsEC están positivamente relacionados con el PIB del país cuyos flujos comerciales se analizan (como importador o como exportador) y con las variables que representan los aspectos que facilitan el

comercio, como tener una frontera o una lengua comunes, y están negativamente relacionados con la distancia. El PIB de los países con los que se comercia tiene un efecto positivo sobre las exportaciones intrarregionales, pero un efecto negativo en las importaciones intrarregionales. El tipo de cambio real tiene el efecto negativo esperado sobre las importaciones intra-EurAsEC, y para las exportaciones intrarregionales el signo del coeficiente es positivo, pero esta variable no es significativa.

Con respecto a los efectos del acuerdo preferencial, los coeficientes de las variables dummy regionales muestran sin ambigüedad que EurAsEC genera un efecto neto de creación de comercio. La pertenencia a la Comunidad Económica Euroasiática tuvo efectos significativos en el comercio bilateral en el área, principalmente en cuanto a las importaciones, sin generar desviación de comercio del resto del mundo. Las importaciones y exportaciones a los países no socios de EurAsEC (al resto del mundo) también se vieron afectadas positivamente, pero en menor medida que los flujos intra-regionales.

Los resultados para los flujos comerciales de Tayikistán muestran que las importaciones se relacionan positivamente con el PIB de Tayikistán y las exportaciones se relacionan positivamente con el PIB de los socios comerciales. Compartir una lengua afecta positivamente a las importaciones y exportaciones. Por otra parte, las exportaciones se ven afectadas positivamente por el hecho de compartir una frontera y negativamente por la distancia; sin embargo, ambas variables no son significativas en la explicación de las importaciones. Ser miembro de EurAsEC afecta positivamente a los flujos de comercio de Tayikistán, en un grado mucho mayor para las importaciones que para las exportaciones, pero en ambos casos en un grado mayor que para el total de los flujos comerciales de EurAsEC.

En el caso de Tayikistán, las importaciones aumentaron considerablemente después de unirse a EurAsEC, tanto las que provienen del área regional como las que provienen del resto del mundo. Sin embargo, las exportaciones han mostrado un desempeño muy pobre, lo que ha generado un enorme déficit comercial. Con todo, el comportamiento de las exportaciones no ha sido tan malo con los socios de EurAsEC como con algunos de los no miembros que eran tradicionalmente socios importantes, sobre todo, la Unión Europea.

Por lo tanto, en el contexto de EurAsEC, la intensificación de las relaciones con los países miembros y reducir los costes del transporte de mercancías hacia estos países parecen ser buenas recomendaciones. Pero Tayikistán no debe concentrar sus esfuerzos de

política comercial sólo en estos socios. Hay economías vecinas más dinámicas fuera de EurAsEC, en particular Turquía y China, las cuales deben ser consideradas como objetivo de las exportaciones de Tayikistán.

Dado que la "Nueva" teoría de la integración económica afirma que en el caso de los países en desarrollo el acento se debe poner en los potenciales efectos dinámicos, en el capítulo cuatro nos centramos en el análisis de los efectos dinámicos de EurAsEC para Tayikistán. En primer lugar, se analizan los efectos para el crecimiento económico, los cuales están muy influenciados por la inversión y, sobre todo, por la Inversión Extranjera Directa (IED). También mostramos evidencia de varios factores que influyen en el deseo de los países en desarrollo por participar en acuerdos de integración regional más allá de los tradicionales efectos estáticos y dinámicos.

Aunque Tayikistan ha hecho un trabajo sustancial para cumplir con los programas de inversión y ha conseguido atraer proyectos de **IED** en algunos años, el desarrollo de la inversión no ha progresado notablemente en Tayikistán. Pero, a pesar de los malos resultados de la IED, Tayikistán, junto con los otros miembros de EurAsEC, disfrutó de un rápido **crecimiento del PIB** a partir del año 2000 (con una media de 7-8%). En el caso de Tayikistán, el crecimiento económico se explica en gran medida por las elevadas y crecientes remesas de emigrantes, y por la asistencia financiera para el desarrollo por parte de los socios multilaterales y bilaterales. En virtud de esos factores externos, de las presiones internas y la incertidumbre, las autoridades se enfrentan a la necesidad de efectuar una transición a un modelo de crecimiento más sostenible e integrador (Grupo del Banco Mundial, 2015). Si bien el crecimiento económico en Tayikistán, aunque inestable, está en línea con el de la mayoría de los países de EurAsEC en los últimos años, el **PIB per cápita** de Tayikistán es insignificante en comparación con estos países. Por lo tanto, podemos concluir que los efectos dinámicos son débiles en el caso de Tayikistán.

Por otra parte, como país en desarrollo, hay varios **factores económicos y políticos determinantes de la integración** que podrían dar racionalidad a la decisión de Tayikistán de unirse a EurAsEC a pesar de que los efectos estáticos y dinámicos sean ambiguos o de una magnitud baja. Los determinantes que hemos considerado se agrupan en tres categorías: perspectiva económica general (objetivo de desarrollo económico), factores relacionados con el mercado y factores relacionados con el comercio.

El **objetivo de desarrollo económico** es el más importante de los objetivos de la integración para los países en desarrollo. En este sentido, el **alivio de la pobreza** fue identificado como uno de los principales objetivos de desarrollo del gobierno de Tayikistán. La tasa de pobreza se redujo de 79,8% en el año 2000 a 32% de personas que viven bajo la línea de pobreza en el año 2014 (Taj Stat, 2015). Ciertamente, Tayikistán ha hecho un trabajo notable en la reducción de la pobreza, con más de un millón de personas que salieron de la zona de pobreza. Sin embargo, con una tasa del 32% en 2013, el país sigue siendo reconocido como el más pobre en el ámbito de EurAsEC.

Partiendo de un **índice de desarrollo humano (IDH)** relativamente alto en la era soviética, después del colapso de la URSS el IDH de Tayikistán cayó fuertemente desde 0,629 en 1991 a 0,535 en 2000 y el país sólo consiguió alcanzar la tasa anterior en 2014. En la actualidad, Tayikistán todavía tiene un IDH inferior al de los demás países de EurAsEC (UNDP, 2015).

En lo que se refiere a los **determinantes relacionados con el mercado**, nos hemos centrado en los efectos potenciales de la integración para el empleo y la productividad, así como para el desarrollo de la industria. A pesar del gran crecimiento económico en el país, no se observó crecimiento del **empleo**, ni en los grandes sectores como los servicios y la industria ni en el pequeño sector de la construcción. Sólo el sector agrícola fue capaz d crear nuevos puestos de trabajo, representando este sector el 66% del empleo total en 2013. Como consecuencia, en un contexto de aumento de la población, la tasa de desempleo aumentó. La OIT estima una tasa de desempleo del 11,5% en 2009, que es la más alta de EurAsEC. Por lo tanto, parece que los efectos positivos de la integración en el mercado laboral no se observaron en términos de empleo.

Dado el aumento de la proporción del empleo en el sector agrícola, el aumento de la **productividad** de la economía depende del aumento de la productividad en la agricultura. Pues bien, a pesar de un cierto aumento en el valor añadido por trabajador en el sector en los últimos años, la productividad agrícola en Tayikistán se encuentra todavía en la posición más baja dentro de la región.

En un contexto de desempleo y pobreza de los hogares, la emigración es la solución para muchas personas en Tayikistán. De hecho, alrededor del 15% de la población total ha emigrado, principalmente a Rusia. En consecuencia, Tayikistán, con un volumen de remesas que representan más del 50% del PIB en 2013, es una de las economías más

dependientes de las remesas de emigrantes en el mundo (Vinokurov et al, 2013). La enorme cantidad de remesas, que han contribuido positivamente a la mitigación de la pobreza y a reducir la presión del mercado de trabajo, también son una fuente de inestabilidad macroeconómica por su contribución a, entre otros aspectos, la apreciación del tipo de cambio y el aumento del déficit comercial.

En relación con los **determinantes relacionados con el comercio**, se analiza el comercio como porcentaje del PIB, el patrón de comercio con los países desarrollados, el comercio intra-regional y el comercio total de la región, y países competitivos versus países complementarios.

Después de la recesión en tiempos de guerra, el **volumen del comercio exterior** de Tayikistán tuvo una dinámica positiva, aumentando entre 1995 y 2013. De 1995 a 2000, exportaciones e importaciones evolucionan a la par siendo la balanza comercial casi nula. Sin embargo, en la última década las exportaciones de Tayikistán se han multiplicado por 1,5, mientras que las importaciones se multiplicaron por 5,1. Así, a principios de 2000 las importaciones como porcentaje del PIB eran del 75%, una década después el nivel de importaciones sigue siendo alto, alrededor del 49% del PIB en 2013, a pesar del crecimiento sustancial del PIB. Por el contrario, en 2013 la proporción de las exportaciones en el PIB del país fue significativamente menor, alrededor del 13%, que se redujo drásticamente desde el 91% en 2000 a raíz de la disminución en el precio mundial del algodón y el aluminio, que son los principales productos de exportación.

En cuanto al análisis geográfico, las exportaciones y las importaciones de Tayikistán aumentaron no sólo con los miembros de EurAsEC sino también, y en mayor medida, con otros países no miembros de EurAsEC como China, Irán y Turquía. Sin embargo, los flujos comerciales con otros países no miembros como la UE y los países del CIS muestran una tendencia negativa. Por lo tanto, a pesar del incremento sustancial del comercio extra-regional, el comercio intrarregional sigue siendo insignificante, representando sólo el 10% del comercio total de EurAzEC en 2013. En el caso de Tayikistán, la proporción del comercio intra-EurAsEc en el comercio exterior total es mayor que el del áresa en su conjunto. Sin embargo, la proporción intrarregional en el comercio exterior total disminuyó del 27% en 2001 al 25,5% en 2013.

No podemos decir que los efectos de la integración sobre el grado de **apertura comercial** e el **patrón de comercio con los países desarrollados** sean determinantes de la

conveniencia para Tayikistán de unirse a EurAsEC. En el año 2000, Tayikistán era una economía muy abierta y el grado de apertura se redujo entre 2000 y 2013. Por otra parte, los flujos comerciales de Tayikistán con los países europeos desarrollados no han aumentado durante el período. La mayor parte de las importaciones, que consisten en bienes de consumo, vienen de China.

El **índice de complementariedad comercial (TC)** que indica en qué medida el perfil de exportación (importación) de un país j coincide con el perfil de importación (exportación) de un país k, muestra valores mucho más bajos para Tayikistán como exportador que como importador. En los dos casos, el índice aumentó entre 2000 y 2013, no sólo con los miembros de EurAsEC sino también, y en mayor medida, con algunos otros países como Turquía y China. Por lo tanto, mientras que en el 2000 se podría razonablemente esperar una expansión del comercio después de un acuerdo preferencial con países de EurAsEC, a partir de los valores del índice en 2013 la relevancia de una integración más profunda con este área no es tan clara, especialmente en relación con el índice TC para las importaciones.

En resumen, el principal objetivo de este trabajo fue analizar empíricamente los efectos de EurAsEc en Tayikistán, tratando de justificar la racionalidad de este país para participar en este proyecto no solo en la etapa actual, sino potencialmente en el futuro y con un mayor grado de integración. La conclusión general es que, si bien los resultados, aunque positivos en su mayoría, son de pequeña magnitud, EurAsEC, bajo el liderazgo de Rusia, es sin duda la alternativa más interesante y plausible entre las posibles opciones de integración regional que se le presentan a Tayikistán.

Si bien, desde el punto de vista de las posibles relaciones económicas, sería interesante una mayor integración con los países de fuera de la órbita exsoviética, en particular, China y Turquía, el interés desde una perspectiva socio-económica general y la viabilidad de las iniciativas a medio y largo plazo son dudosos.

En primer lugar, Tayikistán sigue siendo muy dependiente de Rusia, que aun siendo una fuente de inestabilidad su apoyo no es renunciable a corto y medio plazo. Rusia, que trata explícitamente por todos los medios de mantener el liderazgo en la región y no oculta el objetivo último de recomponer de alguna manera lo que fue el espacio soviético, no va a apoyar ninguna iniciativa en la que se le excluya o en la que se ponga en duda su liderazgo.

En el actual contexto geopolítico, profundizar en la integración con el mundo islámico a través de acuerdos que involucran a Turquía, pero también a Irán, Pakistán y Afganistán, aunque en principio parezcan responder a objetivos de seguridad, no es la mejor manera de asegurar la estabilidad económica y social del país. Por otra parte, mejorar la integración con China a través del acuerdo de Shanghái, parece claramente interesante, pero seguramente Rusia, que también es miembro de esta organización, no va a apoyar el desarrollo de este acuerdo, que en realidad lidera China, frente al desarrollo de EurAsEC, donde claramente no se discute su liderazgo.

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