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**EURASIAN ECONOMIC INTEGRATION: THE CHALLENGES FOR SMALL AND MEDIUM
COMPANIES**

Abstract

Purpose – the main purpose of paper is evaluate degree of trade openness of Kazakhstan towards Eurasian Economic Union and identify whether the Union had effect on the Kazakhstani enterprises.

Methodology – In this article, we use some principles of the collection, analysis, and management of qualitative data. We surveyed two hundred top executives of companies of all sizes, based in Kazakhstan.

Originality/value – Based on the results government and Eurasian Economic Union institutions could improve policy of further integration development.

Findings – Most of companies from primary and tertiary sector did not had an effect of Eurasian Economic Union on their business. Majority secondary sector companies responded that Eurasian Economic Union had effect.

Keywords – economic integration, Eurasian Economic Union, small and medium enterprises, large companies.

Introduction – In the current business landscape affected by a variety of ongoing international integration projects, one of the main problems is the increased uncertainty, and the accelerated pace of economy change. Increasing unpredictability of markets calls for a strategic response from the companies to improve efficiency, competitiveness, and sustainability. Commonly accepted ways to counter the negative effects of uncertainty are the formation of an effective system of strategic planning and the use of complex tools of strategic management. Problems of strategic development are particularly relevant for companies in Kazakhstan due to the fact that Kazakhstan is an active participant in economic integration processes. Ongoing reforms in trade policies lead to changes in the economic, political, and social life of the country. All of these changes are a challenge for Kazakhstani companies. Particularly companies could face complex problems during economic integration process, such as ensuring the survival, selection and implementation of competitive strategies and adapting to new economic realms.

Trading unions and free trading agreements are a very prominent part of our current economic landscape, and they have many important implications for all aspects of our life. This approach set the direction, goals, and the internal logic of the study, in which considerable attention is paid to the evaluation of impact of economic integration on business in Kazakhstan.

Theoretical Background – Modern trends of globalization processes between the industrialized countries and the less developed are guided by the need to protect national interests. One way is the creation of integration alliances based on the expansion of the region. Economic integration is a historical process occurring over many centuries. The essence lies in the integration of interstate association that has its own organizational structure. Member countries of unions tend to deepen integration division of labor and intensive exchange of factors

of production. The idea of a close relationship between two countries primarily for political purposes has been discussed since ancient times. Processes of integration, cooperation, development of a broad cooperation between the countries are most common in the context of globalization. The bases of integration between countries are the processes of the international division of labor based on specialization of each country to produce products according to the presence of absolute advantage. Surplus items formed the basis of origin of barter transactions between tribes, economy and the state. The next stage of integration was overcoming the distances between countries to increase trade and commerce products. These goals were achieved by conducting world tours, organization of trade caravans and ships, which allowed to expand and strengthen the capacity of economic cooperation between trading countries. A striking example of creating a common market was “Silk Way”, which aimed the development of trade relations and economic growth between economies with different resources. “Silk Way” was held during 13-14 centuries and was a bridge between Europe, East and Asia [1].

The term economic integration was first proposed in the works of German and Swedish economists during the 1930s, and has been interpreted as the union that connects different parts together. Economic integration is a form of internationalization of economic activity, which is aimed to coordinate and link countries' economic policies. Economic integration is a process of rapprochement and interweaving the economies of several countries with similar socio-economic systems aimed at creating a single economic body [2].

V. Baranowski also described integration as a “state of interconnectedness of individual differentiated parts into one, as well as the process leading to such state” [3]. This definition, in essence, reflects the approach that is currently getting more popularity. For example, integration by T. Parsons includes components as the actual inter-compatibility of elements, preservation and maintenance of the specific conditions under which the integration system stands out from the external environment [4].

The initial need for analysis and theoretical understanding of the integration processes arose in the integration areas associated with the countries of Western Europe and North America. Overall, the regulations of the general theory of international economic integration created in Western Europe originally served as the methodological basis of the different concepts of interstate integration. That is true, because the countries of the third world in the postwar era were still deeply divided and could not provide bases for integration processes.

Global development trends objectively led a number of rapidly developing countries to seek an effective way to protect national interests. The key element was the creation of necessary conditions for the functioning of the single customs regime within the region and the development of common approaches in regards to third countries.

The first attempt of theoretical explanation of regional integration processes were undertaken in the 1950s by the economists who worked in neo-liberal direction (A. Predol, W. Roepke). Based on the concept of the market as the most effective regulator of the economy, they saw the integration as a creation of a single economic space. To achieve these goals, it was necessary to completely free foreign trade and monetary policies from state control [5].

The next scientific school of regional economic integration is based on the principles of neo-liberalism, and it is a market-institutional school. Its representatives were M. Allais, B. Balassa, J. Weiler, G. Kremer, C. Meyer. They were trying to find a compromise between market mechanisms and state regulation of the economy. They highlighted the need for the market mechanism of integration, and also pointed the important role of the member states in the coordination of economic policies. A general interpretation of economic integration was given by F. Perroux, as a process of uniting several economic units into an union [6].

A. Marchal and P. Wiles also believed that the only true integration is the one that gives equal supply of factors of production to all the components of the integrating space, which no market mechanism can give. [7, 8].

A significant contribution to the development of the theory of regionalism and the process of economic integration in Europe was made by Bela Balassa's Theory of Economic Integration, published in 1961 [9]. According to the theory of B. Balassa, the term economic integration is presented as a process and state of affairs. As a process, economic integration covers measures to eliminate discrimination between economic units, belonged to different countries. As the state of affairs it represents the absence of different forms of

discrimination between national economies. His book was focused on the first interpretation of economic integration. B. Balassa differentiated five stages of integration:

1. Free trade zone - involves the elimination of tariffs between members;
2. The Customs Union - involves the adoption of common external tariff (CET) among all member countries;
3. Single market – restrictions on free movement of factors are eliminated;
4. Economic Union – the process of harmonization of national policies begins;
5. Full economic integration – where monetary, fiscal, social and countercyclical policies are unified.

Economic integration refers to economic partnership between countries and unification of their economic policies, leading to increased economic

dependences between them. It happens because of several advantages that may be achieved. There are various degrees of integration, depending on the type of agreement made between the trading countries, and the degree to which barriers between them are removed.

According to the research conducted by Nguyen and Enderwick (2016), economic integration has both positive and negative effects on the local companies' development. They have interviewed five big domestic food processing firms, and revealed what benefits and drawbacks of the Association of Southeast Asian Nations (here and after ASEAN) brings to them. One of the advantages of economic integration according to interview is the access to new markets, and one of the disadvantages is the increased foreign competition [11]. However, Kyophilavong, Vanhnalal and Phonvisay (2017) argue that foreign competition caused by lower tariff barriers is expected to have positive effect on the SMEs. They mention that the external companies' entrance can force the domestic firms to become more innovative, productive and as a result more competitive [12]. But, there is evidence that this does not always work. Despite the advantages of lower tariff barriers between countries-members of the particular economic integration, sometimes trade can face non-tariff barriers. Thomas and Marandu (2017) give an example of the African Botswana. The country is a member of Southern African Development Community (here and after SADC) economic integration, but it cannot fully benefit from this membership, because the administrative processes and procedures are too bureaucratic and owners of firms are not always fully aware of the economic integration [13]. The same problem can arise in most developing countries of Africa and other world regions. The next issue that can be faced by the company within the economic integration is the need to change the structure of the firm to be more appropriate for going international. According to Gatto (1999), this process is more difficult to implement for the companies that were operating internally before, and have to face changes in order to compete and survive. In his research, he describes the case of industrial SMEs of South American trade bloc MERCOSUR that have also had a problem with the managing the change and taking the opportunity of economic integration [14]. On the other hand, Huin, Luong and Abhary (2003) claim that the industrial SMEs of ASEAN met and implemented the changes connected with internalization quickly and reactively [15]. They could do this with the help of advanced technologies. This fact proves that the economic integrations in various regions can be followed by different actions and consequences on SMEs. Therefore, it cannot be claimed that the impact of one economic integration on companies' performance would be same in another one. Economic integration emphasizes on creating job places and assisting the SMEs in industries that are considered to be crucial for the economy of the unions. Thus R.J Dilger (2016) in the «European Union small Business Act» concluded that economic future depends mostly not on the how companies in member states compete against each other but rather how they as a whole compete in markets with the rest of the world [16]. SMEs are the significant growth engine of the economic communities. Ong Keng Yong (2016) at all highlighted that connections and infrastructure should be improved so that businesses could be aware of and take advantage of the benefits acquiring from the economic integration. Like in ASEAN there is ongoing process of tariff reduction and reducing of obstacles facilitating trade and access to new markets. However, business registration process and access to finance differs a lot in Singapore, Malaysia in comparison with less developed member states, which can create problems for businesses. The implementation of policy of Cooperation between member states will assist SMEs to grow internationally [17]. Hadi Soesastro (2005) idea was that regional trade created by integration became a strong buffer from the export fluctuations and global economic changes. Also he mentioned the importance

of common policy for all members of ASEAN as income inequalities are considered to be main obstacles to creating the opportunities for fair competition within the community [18]. The flexibility and ability of SME sector to adjust to the changing environment was discussed by Anna Bąkiewicz (2012) on example of Poland. After the EU accession visible growth of demand for domestically produced goods, simplified import and export procedures and expanded market created an economic boom with positive effects and modernization. SMEs managed to predict some changes thus easily adapting to the new business environment [19]. Thi Thanh Hai Tran (2015) in his work also mentioned flexible market solutions of SME as one of the main factors of effective integration as well as understanding and compliance with the laws of ASEAN countries on the way of joining the community. From the survey of 2500 SMEs in Vietnam 5 main challenges faced by the businesses were revealed following by 8 steps that should be incorporated to cope with increased competition as the result of joining the union. The proactive integration requires support from government and that is true for every country joining any community [20].

An Overview of the Union.

Current global processes lead to a need of assessing the appropriateness of the chosen development strategy of Kazakhstan by determining its place in the global and regional processes in Eurasia.

March 1994, the President of the Republic of Kazakhstan N.A.Nazarbayev has proposed the concept of forming the Eurasian Union, which was going to be based on a voluntary, equitable integration, joint political and economic development of the post-Soviet states, and the entrance of Commonwealth of Independent States (here and after CIS) countries to a leading position in global economy [21].

That concept presents the principles, objectives and mechanism of formation of the Eurasian Union, provides the establishment of a number of coordinating supranational structures, sets out the basic directions of cooperation - the economy, science, culture, education, environment and defense.

Participation in integration unions is foreign policy priority for the strategy of Kazakhstan. Great opportunities to expand its capabilities are available in the deepening integration of Kazakhstan in the framework of regional integration. A main goal of integration is achievement of stability, economic progress and military-political security in the region. Evolution of economic integration process is shown in a Table 1.

Table 1 – Evolution of Eurasian Economic Union

Eurasian Economic community	EurAsEC (2000-2014)	free trade area	no barriers between trading countries,	Belarus, Kazakhstan, Kyrgyzstan, Russia, Tadjikistan
Eurasian Customs Union	EACU (2010)	customs union	no customs are levied inside the union , imposing a common external tariff on all goods entering the union	Armenia, Belarus, Kazakhstan, Russia
Eurasian Economic Space	EES (2012)	single market	the free movement of persons, goods, services and capital	Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia
Eurasian Economic Union	EEU (2015)	single market	the free movement of goods, capital, services and people and provides for common policies in macroeconomic sphere, transport, industry and agriculture, competition and antitrust regulation.	Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia

As we can see from table 1 EurAsEC is an example of free trade area including a group of countries that agree to gradually eliminate trade barriers (quota, tariffs) between themselves. Each member country retains the right to charge its own external tariff towards other non-member countries. In trade relations between members, there may be free trade in some products, and some protection in other products.

The main tasks for the EurAsEC are the following:

- completion of registration in full free-trade regime, the formation of a common customs tariff and a unified system of non-tariff regulation;
- the free movement of capital;
- creation of a common financial market;
- harmonization of principles and conditions for the transition to the single currency within the Eurasian Economic Community;
- establishing common rules for trade in goods and services and their access to domestic markets;
- a common unified system of customs regulations;
- development and implementation of interstate target programs;
- creating equal conditions for production and business activities;
- establishment of a common transport market and the integrated transport system;
- formation of a common energy market;
- creating equal conditions for foreign investment in the markets of the Community;
- ensuring the free movement of citizens of the EurAsEC states within the Community;
- harmonization of social policies in order to create community welfare states, providing a common labor market, common educational space, coordinated approaches to healthcare issues, labor migration, and others;
- approximation and harmonization of national laws, ensuring interaction of legal systems in order to create a common legal space within the Community [22].

Table 2 presents the geographic and economic characteristics of Union members. As we can see Russia has utterly dominated by area, market size, national income.

Table 2 – Some basic indicators in EurAsEC countries

Country	Areas (000km ²)	Population (millions)	Life expectancy at birth (years)	GNI per capita	
				\$USA	Average Growth
Belarus	207.6	9.5	71.5	1380	-3.1
Kazakhstan	2724.902	17.6	69.6	1260	6.1
Kyrgyzstan	199.951	5.9	70.8	280	1.5
Russia	17125.19	143.5	70.3	1710	-0.3
Tajikistan	142	8.5	69.6	-	-

Sources – Human Development Reports, 2016.

As table 3 indicates, Kazakhstan posted worse numbers than the average in the EurASEC area in 2014 and 2015 in the category of investment.

In economics as more prosperous country as lower inflation, current debt ratio and debt service ratio. Debt service ratio is the ratio of debt service payments of a country to that country's export earnings. Kazakhstan performed better than regional average with respect to its growth rate, saving, current debt ratio, inflation, current debt to GDP ratio.

Table 3 – Macroeconomic Performance of Kazakhstan as compared to the EurAsEC

Indicators	2014			2015		
	Kazakhstan	EurAsEC	Difference	Kazakhstan	EurAsEC	Difference
Growth rate (%)	4.2	3.46	0.74	1.2	0.9	0.3
Inflation (%)	5.8	9.06	-3.3	1.8	5.9	-4.1
Investment (% of GDP)	1.2	1.96	-0.76	1.0	2.14	-1.14

Continuation Table 2.2

Saving (% of GDP)	29	18.8	10.2	25	18.6	-6.4
Current Debt/GDP (%)	12.6	15.54	-2.94	19.3	21.06	-1.76
Debt Service/ Exports (%)	1.0	5.28	-4.28	1.5	6.74	-5.24
Source – The World Bank 2014-2015						

The next step of integration is formation of customs union. The Eurasian customs Union formed by Belarus, Kazakhstan and Russia was established in 2010.

A customs union consists of a group of countries that eliminated all trade barriers between members and adopted a single policy towards all non-member countries. Each country in a customs union is no longer free to determine its own trade policy towards non-member countries, but must adopt the policy agreed upon by the customs union. The member countries of the customs union act as a group in all trade negotiations and agreements with other non-member countries. A customs union therefore involves a higher degree of economic integration than a free trade area. The agreement on the establishment of the Customs Union stipulates the following:

- removal of internal customs borders between member states;
- transfer of customs control at the outer perimeter of the union;
- elimination of customs procedures in mutual trade in goods of national production;
- standardization of forms and methods of collecting foreign trade statistics;
- approval of forms and methods of providing benefits to participants of foreign economic activity;
- introduction of a common to all member states of the Customs Union tariff and non-tariff regulation for trade with third countries;
- creation of a generalized system of preferences.

The Eurasian Economic Space was established in 2012 for the purpose of common market that provides the free movement of persons, goods, services and capital. The Eurasian Economic Space initially consisted of Belarus, Kazakhstan, and Russia, and was expanded by joining Armenia and Kyrgyzstan in 2015 [23]. The key direction at this stage is the creation of a common market, in particular, the market of energy resources.

The EAEU introduces the free movement of goods, capital, services and people and provides for common policies in macroeconomic sphere, transport, industry and agriculture, energy, foreign trade and investment, customs, technical regulation, competition and antitrust regulation. The Eurasian Economic Union is designed to achieve a number of objectives such as improve resources allocation, efficiency in production, competition, reduce price for consumers and expand consumer choice, increase investment by firms that want to take advantage of the larger market size.

Methodology.

The approach based on the Degree of Trade Openness describes what changes might happen with respect to the degree of openness of a country towards member countries of economic union. If a country's trade increases with its Union member countries after integration, then it means that the country is using its resources more efficiently and gets benefits from participating in the union. The data in the country's openness and its trade balance with respect to the Union show how the country's trade results within the Union has changed overall as an effect of integration. The degree of is calculated using the country's export, its imports and the sum of the two. Mathematically, the rate of the openness is calculated with a simple equations:

$$DTO_x = \frac{\text{Exports of Kazakhstan to EAEU in year } t}{\text{Total Exports of Kazakhstan in year } t} \quad (1),$$

$$DTOm = \frac{\text{Imports of Kazakhstan to EAEU in year } t}{\text{Total Imports of Kazakhstan in year } t} \quad (2),$$

Comparing the change in the two measures for the pre- and post-integration periods, we can determine whether the trade sector in Kazakhstan has overall benefited or has performed worse in the aftermath of integration.

Table 4 – Kazakhstan to EAEU degree of trade openness ratio

	2011	2012	2013	2014	2015	2016
DTOt	19.6%	18.7%	19.2%	18.3%	21.3%	21.9%
DTOx	9.0%	7.9%	7.8%	9.0%	11.1%	10.7%
DTOm	43.8%	38.9%	39.0%	36.2%	36.7%	38.4%

Calculated openness ratios are presented in table 4 and graphed in figure 1. In the case of exports, Kazakhstan's openness toward its union partners tended to decrease steadily from 2011 to 2014 during Customs Union period, before picking up again in 2015 when EAEU came into force. On the imports side, the openness measure generally fluctuated from 2011 to 2016, with a slight increase starting from 2015 as a result of EAEU. The overall DTO based on total trade (export plus import) shows increasing trend in trade among Kazakhstan and its union member countries.

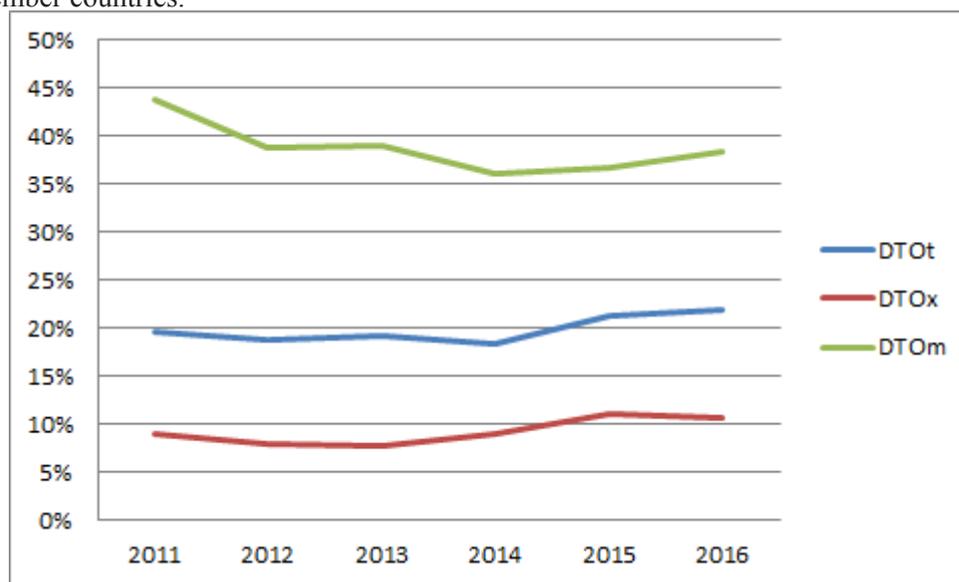


Figure 1 – Kazakhstan to EAEU Degree of Trade Openness in %, 2011-2016

The data shows that overall trade among Kazakhstan and EAEU member countries increased. Thus these positive results encouraged to look into the effect of integration on Kazakhstani enterprises directly.

The next methodology used is survey of companies. The survey is a methodology, where a sample of subject is drawn from a population or firms and studied to make inferences about the population and firms [24]. Indeed, a group of companies operating in Kazakhstan was approached for defining the effect of EAEU on their activity. This method is an efficient mechanism for data collection.

The survey questionnaire was administered to 204 firms from different sectors of economy in Kazakhstan; the response rate was 90%. Among them we selected 184 full completed answers.

This part of the paper tries to determine whether there is any relationship between membership in economic integration and business in a member country. A questionnaire aims to find out whether production and service companies in Kazakhstan feel the effect aftermath of EAEU. In order to assess the respondents' strength

of opinion closed end type of questions was used for the questionnaire. Respondents could choose among available answers to help us find association (positive, negative, neutral) between economic integration and companies activity.

The companies in our study represented a wide range of industries, including energy, industrial goods, construction, financial services, catering, retail, IT and telecommunications. Following classical view of three-sector theory developed by Fisher (1939) we distributed respondents into three sectors of activity: extraction of raw materials (primary), manufacturing (secondary), and services (tertiary) [25]. Primary sector includes extraction of raw materials, mining and agriculture. Secondary / manufacturing sector concerned with production of final goods. Tertiary sector concerned with offering services as trade, IT, logistics, telecommunication, retail, tourism, banking, entertainment.

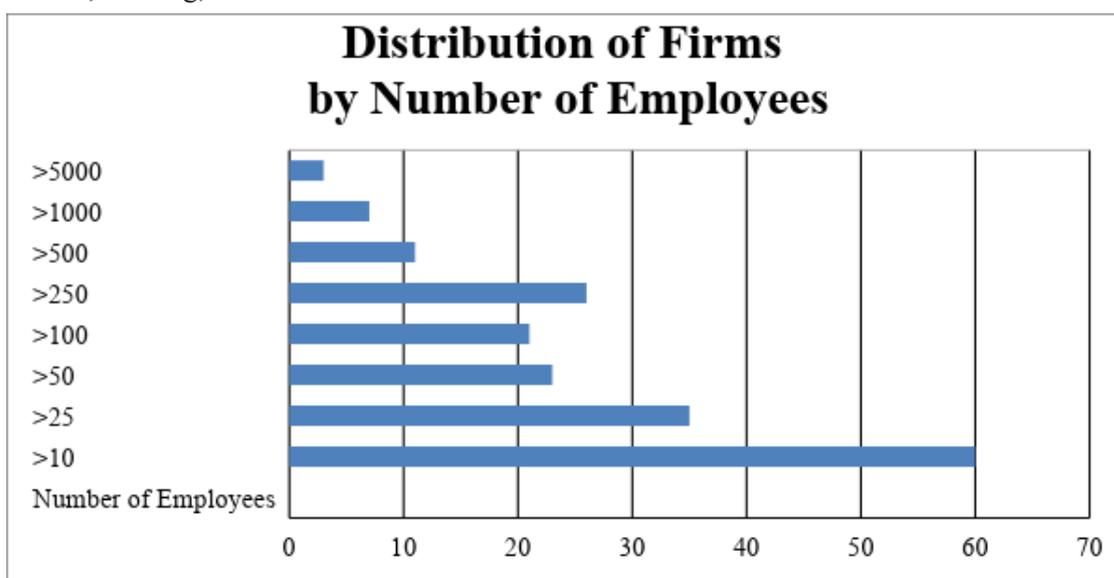


Figure 2 – Distribution of Respondent Companies by Number of Employees

Figure 2 shows how companies in this survey are distributed by the size of companies. According to the Law of Republic of Kazakhstan “About private entrepreneurship” Kazakhstani law defines a small business as one without the establishment of a legal entity (individual entrepreneurs) with no more than 50 employees. A medium sized business is a company with between 51 and 250 employees. Large businesses are defined as separate legal entities carrying out entrepreneurial activity with more than 250 employees [26]. As we can see from Figure 2, majority of the companies are small enterprises – 63% of respondent companies, 25% medium enterprises and 11% large enterprises representing all three sectors of the economy.

To assess companies’ sensitivity towards Eurasian economic integration, we asked the surveyed executives whether integration had an impact on their respective businesses. They were asked whether this impact was positive or negative. Positive effect includes companies’ intentions for regional expansion, increasing sales and whether they are acting to improve their competitiveness to take advantage of integration.

Table 5 – Companies responses

Actual	Effect	No effect	
Primary	6	11	17
Secondary	35	31	66
Tertiary	31	70	101
Total	72	112	184
Expected	Effect	No effect	

5. The share of companies from primary sector without the effect from economic integration on their business is 9,82%.

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Резюме

В данной статье исследуются интеграционные процессы на евразийском пространстве, уделяется особое внимание новому этапу интеграции – евразийскому экономическому союзу. Был рассчитан показатель открытости торговли между Казахстаном и странами-участницами до вступления и после вступления в союз. Авторами было проведено качественное исследование эффекта от экономической интеграции на предпринимательскую деятельность предприятий Казахстана в трех секторах. Результаты исследования представляют интерес правительству и институтам Евразийского экономического союза для улучшения политики дальнейшего развития интеграции.

Түйін

Бұл мақалада еуразиялық кеңістіктегі интеграциялық процестер зерттеліп, интеграцияның жаңа кезеңіне - Еуразиялық экономикалық одаққа ерекше назар аударылады. Қазақстан мен одаққа қатысушы мемлекеттер арасындағы одаққа кіргенге дейін және кіргеннен кейінгі сауда-саттықтың ашықтығы индикаторы есептелген. Авторлар экономикалық интеграцияның қазақстандық кәсіпорындардың кәсіпкерлік қызметіне ықпалын сапалы зерттеу әдісімен қарастырды. Зерттеудің нәтижелері үкімет пен Еуразиялық экономикалық одақтың институттарына интеграцияны одан әрі дамыту саясатын жетілдіру үшін пайдалы болады.

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