The integration of financial markets amid the formation of the Eurasian Economic Union

Gulmira Bulatovna Nurlikhina[1], Gani Kalikulovich Turabaev[1], Marlen Kapashevich Kolbayev[2], Raziya Maratovna Ashimova[1], Ermek Amantaevich Alpisov[3]

[1]Institute of Master and PhD Doctoral Programs of Kazakh National Pedagogical University named after Abay, Kazakhstan
[2]Zhetisu State University named after I.Zhansugurov, Kazakhstan
[3]Administration of Taldykorgan, Kazakhstan
Email: rector@kaznpu.kz

Abstract. This article examines the major stages in the process of integration in the Eurasian space. The author explores the trends in and indicators of the development of the financial markets of the Customs Union (CU) and Common Economic Space (CES) states, including the dynamics of state budget revenue and deficit, the volume of the monetary base and liquid funds, and the volumes of lending and currency trading in the CU and CES states. The author's findings indicate an increase in the level of integration of the CU and CES states in the sphere. The author points up the persisting barriers to the creation of a common financial market and the major focus areas of work on enhancing the integration of the financial markets of the CU and CES states, which will help to more fully realize the potential of the financial systems of the CU and CES member states: speeding up the processes of harmonizing legislation, removing barriers to the operation of the branches of financial institutions, forming an integrated CES payment system, and harmonizing and unifying the legislation of the CES member states in the insurance area.

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Introduction

One of the major trends in the global economic system is the globalization of the financial market and intensification of integration processes in the financial sphere. The integration of the financial markets of developing countries into a single global financial system helps obtain access to global capital markets, facilitates an increase in market deals, and, overall, has a positive impact on economic stability [1].

The benefits of financial globalization include the development of internal financial markets, improvement in the quality of institutional governance and enhancement of discipline in dealing with issues of macroeconomic policy, and improvement in overall labor productivity, which speeds up the economic growth of national economies [2].

The creation of a powerful financial market for the CU and CES member states has become topical due to the need for reducing their dependence on outside funding and minimizing the impact of external factors on national economies [3].

The integration of the financial markets of the CES member states will help diversify risks, ensure more efficient distribution of financial capital, improve the quality and competitiveness of financial services, and boost the accessibility of credit resources for national economies [4].

Main part

The process of integration in the Eurasian space has a history that spans over 20 years. In actuality, attempts to preserve on new principles the economic relations which had been around for decades began right after the disintegration of the USSR [5].

The process of economic integration involves several consecutive stages.

The first stage of the process of integration (1994) saw the creation of the Free Trade Area (FTA), which incorporated CIS states, including Kazakhstan, Russia, and Belarus. The creation of the FTA was aimed at ensuring free movement of goods produced in the member states and was construed as a stage of transition to the formation of the Customs Union. In October 2011, CIS states signed a free trade agreement with the major focus on integration into the global economy and international trade system.

The second stage of the process of Eurasian integration was marked by the creation of the Customs Union as a form of trade-economic integration providing for a single customs territory for the member states. The agreement dated October

6, 2007, which was signed by the Republic of Belarus, the Republic of Kazakhstan, and the Russian Federation, revoked customs duties and restrictions of an economic nature within the customs territory. With the adoption of the Customs Code in 2010, there entered into operation the uniform system of tariff regulation in the customs territory of the CU member states. As of July, 2011, the Customs Union operates in a full-format regimen by all international standards.

The third stage of Eurasian integration is associated with the formation of a common economic space. The functioning of the Common Economic Space presupposes the coordination of the economic policy of the member states with regard to the key sectors – macroeconomics and the financial sector, transport and power generation, industry and the agro-industrial complex, etc.

On January 1, 2012, the Customs Union states took an important step towards regional integration [6]: 17 fundamental international agreements entered into effect, including the Agreement on Creating Conditions in Financial Markets to Ensure Free Movement of Capital [7].

This document establishes the procedure for arranging information exchange between the authorized bodies of parties in the banking sphere, in the currency market, the securities market, and the insurance sphere. The same agreement provides for effecting the harmonization of legislation in financial markets by December 31 inclusive of international rules and standards.

Currently, there has been prepared a draft agreement on the Eurasian Economic Union, which incorporates about 70 codified international agreements that make up the agreement-legal base of the CU and CES, as well as norms relating to the expansion of the common market over segments not covered before, namely the energy sector and the market of services.

The major rules of regulating financial markets have been provided in Section XVI of the draft agreement on the CES. The definition of the term "common financial market" and its following criteria have also been provided:

– harmonized requirements as to regulation and oversight in the sphere of financial markets;

– the mutual recognition of licenses, provision of financial services throughout the territory of the Union without the need for an additional institution as a juridical person;

– administrative partnership between authorized bodies, including through information exchange;

– the step-by-step removal of barriers (exclusions and limitations) in the banking sector;

– the creation in 2025 of a supranational body for the regulation of the financial market of the CU and CES in Almaty, which will perform regulatory functions for the purposes of creating a common financial market.

The development of relations in the area of forming a common financial market between the member states of the Eurasian Economic Union being formed has quite robust positive dynamics.

Over the period of 2010-2013, revenues in the consolidated budgets of the CU and CES member states increased 30.7% in Belarus, 44% in Kazakhstan, and 43.3% in Russia (Table 1).

Table 1. The dynamics of revenues in the consolidated budgets of the CU and CES member states

	2010	2011	2012	2013	Change	
					billion US dollars	%
Belarus	16.3	16.8	18.9	21.3	5	30.7%
Kazakhstan	44.6	59.6	62.2	64.5	19.9	44.6%
Russia	527.6	710.5	754	755.8	228.2	43.3%

Despite an increase in the volume of national debt, the national debt of all the CU and CES member states stayed below the threshold of "50% of GDP" established as part of the Agreement on Coordinated Macroeconomic Policy dated December 9, 2010.

The decrease in the deficit of state budgets relative to GDP attests to the enhancement of the sustainability of the economic development of the CU and CES member states (Table 2).

Table 2. The deficit (-)/surplus (+) of the state budget, % of GDP

States	2010	2011	2012	2013
Belarus	-2.5	0.8	0.8	-0.2
Kazakhstan	-2.5	-2.1	6.6	6.3
Russia	-4	0.8	0.4	-0.4

In Belarus, compared with the rest of the CU and CES member states, external national debt prevails over internal debt. Indicators of the ratio of external debt to the total volume of national debt in the Republic of Belarus and Russia have a trend towards going down, while they have not changed for the Republic of Kazakhstan (Figure 1).

There was an increase in the volume of the monetary base of all the CU and CES member states over the period under examination (Figure 2). More specifically, this indicator increased 3.3 times in the Republic of Belarus, 9.7% in the Republic of Kazakhstan, and 28.3% in the Russian Federation.

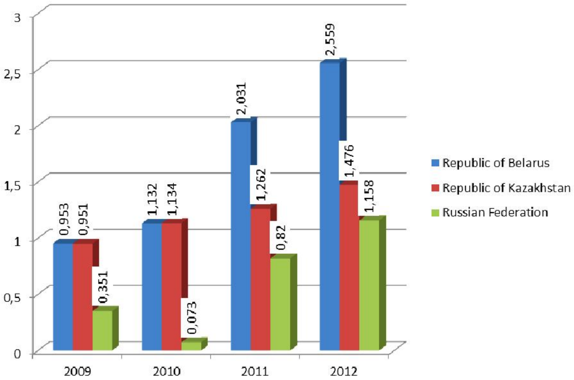

Figure 1. The ratio of external debt to the total volume of the national debt of the CU and CES member states

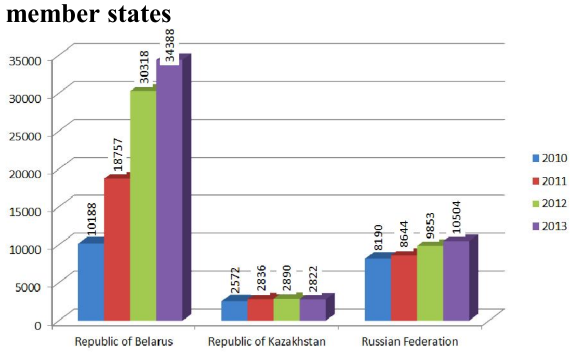

Figure 2. The dynamics of the monetary base of the CU and CES member states over the period of 2010-2013, billion national currency units

Note that over the period of 2010-2013 there was a substantial increase in the liquid portion of the money supply, which is available for immediate use as a medium of payment (the M0 aggregate). The dynamics of the growth of the states' M0 aggregate over the period of 2010-2013 are provided in Figure 3.

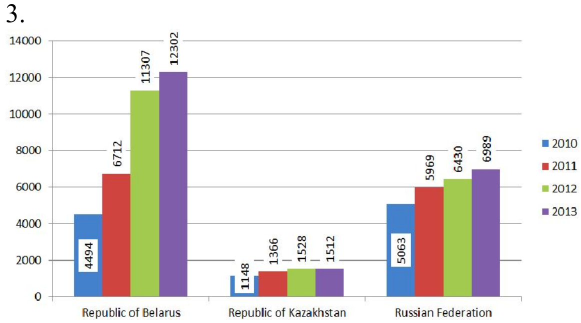

Figure 3. The dynamics of the more liquid money supply of the CU and CES states for the period of 2010-2013, billion national currency units

The indicator grew the most (2.7 times) in the Republic Belarus, the figure being 31.7% and 38% for Kazakhstan and the Russian Federation, respectively.

The development of relations between the member states of the Eurasian Economic Union being formed had a positive effect on the lending market as well. Over the period of 2010-2013, there was an overall 2.1 times increase in the volume of bank lending to juridical persons per capita, while loan debt reached 1953 US dollars as of year-end 2013 (Figure 4).

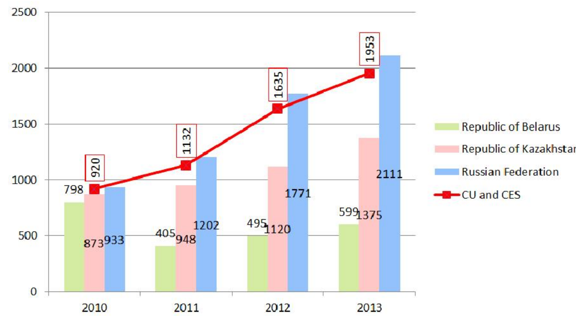

Figure 4. Loan debt on loans granted to natural persons, per capita (US dollars)

The combined assets of the banking system of the CU and CES member states increased more than 1.5 times over the last four years: from 1233 billion US dollars in 2010 to 1896 billion US dollars in 2013.

There was a substantial increase in the volume of currency trading over the period under examination, while the volume of deals in stock markets shows negative dynamics (Table 3).

Table 3. The dynamics of the volume of trading in the currency-money market of the CU and CES member states, million US dollars

CU and CES states	2010	2011	2012	2013	Change	
					+/-	%
Volume of currency trading						
Belarus	21137	17455	29949	31535	10398	49.2%
Kazakhstan	106882	106207	96063	120640	13758	12.9%
Russia	4947958	7149642	9515706	11839252	6891294	139.3%
Volume of trading in stock markets						
Belarus	8164	7697	5081	5554	-2610	-32.0%
Kazakhstan	99613	94817	88270	89345	-10268	-10.3%
Russia	908959	1044361	776698	755028	-153931	-16.9%

At the same time, all the CU and CES states demonstrate stable negative dynamics on the volume of trading in stock markets.

Among the primary indicators of financial integration are direct foreign investments (DFI). The per-unit share of the combined volume of investments of the three CU and CES states totals 3.09% of the total volume of global investment. There has been an increase in the intensity of the mutual financial flows of the CU and CES member states over the period of partnership [8].

Russia is the main investor in the economy of other CES states, followed far behind by Kazakhstan. A high level of investment integration has been seen in the Russia-Kazakhstan and Russia-Belarus dyads [9].

The volume of DFI in the Russian Federation from the Republic of Kazakhstan increased 6 times from 2010 ($46 million) to 2012 and reached $274 million. The international investment position of the Republic of Kazakhstan with the Russian Federation totaled $2 497.9 million as of 31.03.2013 (assets – $8 450.3 million, liabilities – $5 952.3 million) [10]. A considerable portion in the structure of financial flows between the Republic of Kazakhstan and the Russian Federation is accounted for by other investments (in the assets of the Republic of Kazakhstan – 88.7%, in its liabilities – 60.3%). Direct investments account for a considerable portion of liabilities, 31.3%.

The volume of DFI from the Republic of Belarus in the Russian Federation increased 3 times over the period of 2010-2012, reaching $141 million in 2012 compared with $34 million in 2010.

The volume of investment in the Republic of Kazakhstan from the Republic of Belarus increased 2.9 times and totaled upwards of $122 million in 2012 versus $41.7 million in 2010.

The result of operations on granting and attracting DFI is the state of their reserves (Table 4).

Table 4. Accumulated DFI across the CU and CES member states as of year-end 2012

DFI recipient state	Accumulated DFI of investor states, $ billion		
	Russia	Kazakhstan	Belarus
Republic of Belarus	7.54	0.01	x
Republic of Kazakhstan	10.86	x	0.05
Russian Federation	x	4.42	0.28
Total	18.40	4.43	0.33

On the whole, the dynamics of major indicators of the development of financial markets indicate an increase in the level of integration of the CU and CES member states in the sphere. This is attested to by the findings of an analysis conducted in 2014 by the Eurasian Development Bank Center for Integration Studies [11] (Figure 5).

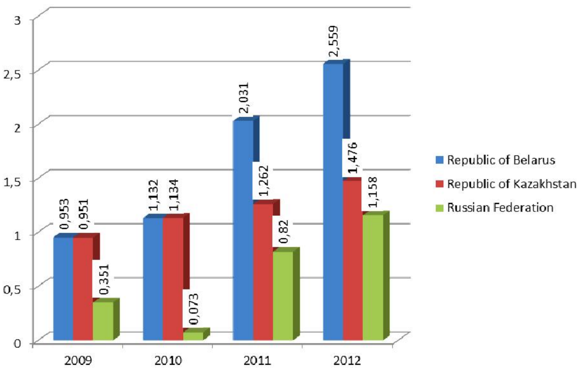

Figure 5. The dynamics of the index of convergence of indicators of the financial policy of the CU and CES member states

At the same time, it should be noted that despite many positive takeaways from the development of integration processes, there remain a number of barriers to the creation of a single financial market:

– an increase in the scale of illegal movement of capital out of the CU and CES member states through schemes taking advantage of the lack of customs processing and customs oversight over goods moving between the CU and CES member states;

– substantial differences in national legislation in the banking sector, insurance market, and securities and currency markets, which are mainly oriented towards internal development are not fully inclusive of integration goals;

– an increase in geopolitical risks, which augments the vulnerability of national payment systems;

– a lack of practical steps on deepening integration and forming a single financial market (which is expected to be launched only by 2020).

Currently, there are substantial reserves for deepening the corporate integration of the financial markets of the CU and CES member states, which can be facilitated through:

– speeding up the process of harmonizing legislation with a view to ensuring a single financial competitive environment;

– aspiring towards the removal of all barriers to the full-scale operation of the branches of financial institutions in the territory of the Common Economic Space;

– delving into the issue of the possibility of establishing an integrated payment system within the CES with a view to minimizing risks associated with effecting payment-settlement operations;

– harmonizing and unifying the legislation of the CES member states in the insurance sphere. There is a need to activate the interaction of the insurance sectors of the CES member states and engage members of the insurance business community in work on the "Road Map" for the legislation of the CES member states in the insurance sphere.

Conclusion

Amid the globalization of financial markets and stiffening rivalry for markets and investment, one of the key factors in the competitiveness and viability of financial systems is the deepening of integration processes through projects by the Eurasian commonwealth. Further work on the removal of barriers will help to more fully realize the potential of the financial systems of the CU and CES member states, which, in turn, will lead to the acceleration and deepening of integration processes and creation of a common financial EaEU market.

Corresponding Author:
Dr.Nurlikhina Gulmira Bulatovna
Institute of Master and PhD Doctoral Programs of Kazakh National Pedagogical University named after Abay
Email: rector@kaznpu.kz

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