

Problems of the economic integration of the countries of the Central Asia in the context of globalization

Malik Borbugulov

Abstract: Regional integration is a hot topic of research on Central Asia. The first part of the paper reviews the theories of the economic integration. The second part is about the European Union as an example of successful economic integration. The third one is about the problems of the Central Asia, which creates obstacles for economic integration in the region.

Keywords: integration, European Union, Central Asia.

1. Theories of economic integration.

Economic integration defined by Balassa¹ as a process and as a state of affairs. Economic integration comprises the set of political and economic measures to eliminate discrimination between economic units that belong to different national states. It represents the absence of discrimination between national economies.

Integration according to Machlup² is the process of combining separate economies into a larger economic region. Machlup³ and Staley⁴ further argue that integration is concerned with the utilization of all opportunities of efficient division of labor".

There are several forms of economic integration. They have different degrees of discrimination between partner countries and between them and third parties. The most common forms referred are the following.

Preferential Trade Agreements (PTAs): are arrangements through which member countries receive reductions in tariffs or preferential treatment within quantitative restrictions on their trade with other member countries while maintaining against third parties a normal level of trade restrictions. This type of arrangement frequently applies only to a group of products and is unilaterally granted.

Free Trade Areas (FTAs): accords by which member countries eliminate trade barriers among themselves while maintaining their individual national barriers against third countries. The disparity in the level of discrimination against third parties makes critical the control of trade

¹ Balassa, B. (1987) Economic Integration. *The New Palgrave: A Dictionary of Economics*, New York: Stockton Press

² Machlup, F. (1977). *A history of thought on economic integration*. New York: Columbia University Press.

³ Machlup, F. (1977). *A history of thought on economic integration*. New York: Columbia University Press.

⁴ Staley, C. E. (1977). Review of A history of thought on economic integration, by Fritz Machlup. *Annals of the American Academy of Political and Social Science*, 434.

flows coming through the different partners into the Free Trade Areas. Normally, strict rules of origin and expensive customs inspection are necessary to prevent trade deflection.

Customs Unions (CUs): member countries remove all barriers to trade among themselves and adopt a common set of tariffs for third countries; consequently, the adoption of intra-Customs Union rules of origin and the need for customs inspection become obsolete. The level of the common tariff is critical in determining the economic outcome of a Customs Union and may be relevant in defining other domestic economic policies given its potential impact on public revenues (although Customs Unions do not imply per se any harmonization of domestic policies).

The following definition of the customs union theory (economic integration theory) was by Lipsey as follows: "The theory of customs unions may be defined as that branch of tariff theory which deals with the effects of geographically discriminatory changes in trade barriers [among countries]"⁵

Common Markets (CMs): these are arrangements that comprise all the characteristics that define a Customs Union, but also allow for full mobility of factors of production. The member countries within a Common Market define common policies regulating factor flows with third countries. In this case, the need for domestic policy harmonization is more compelling than in the Customs Union's case. However, there is no formal obligation for member countries to move in this direction⁶.

Traditional Economic Integration Theories

Studies discussing trade gains from the integration and explaining the theoretical implications of preferential trade agreements are based on the study of Viner⁷. His book titled: "The Customs Union Issue" was reviewed by many researchers in well known journals. These also include Catudal⁸ who describes Viner's work on the economics of customs unions as the first time that anyone has subjected such a detailed and critical analysis of the issue of gains from economic integration from a purely economic point of view.

Salera⁹ has also described Viner's book as the first rigorous treatment of the subject. Other book reviews of Viner's book include Cheng, Henderson, Ellsworth, Martin, Imlah, Stopler, and

⁵ Lipsey, R. G. (1960). The theory of customs unions: A general survey. *The Economic Journal*, 70 (279).

⁶ Argüello, Ricardo. (2000). Economic Integration. An overview of basic economic theory and other related issues. *Economía. Serie documentos, Borradores de investigación. No. 3*.

⁷ Viner, Jacob. (1950). *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

⁸ Catudal, H. M. (1951). Review of The customs union issue, by Jacob Viner. *The American Journal of International Law*, 45 (1).

⁹ Salera, VI. (1951). Review of The customs union issue, by Jacob Viner. *The Journal of Political Economy*, 59 (1).

Kreps. We will review Viner's traditional customs unions theory, as well as the subsequent developments made by many authors, especially Meade¹⁰ and Lipsey¹¹.

Viner's study was the first who identified the concrete criteria to distinguish between the possible advantages and disadvantages of economic integration. Viner's so-called "static analysis" of economic integration has divided possible effects of economic integration into the well-known effects of trade creation and trade diversion.

Trade creation is the case when two or more countries enter into a trade agreement, and trade shifts from a high-cost supplier member country to a low-cost supplier member country in the union.

Trade diversion occurs 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 inside the union. This may be the case if common tariff after the union protects the high cost supplier member-country inside the union.

This can be illustrated by the following example:

Suppose that country 1 enters a customs union with country 2 or 3.

Country 1 will be better off because the domestic price of product X in country 1 (40) is higher than in country 2 (30) or 3 (25). The direction of trade will shift from a high-cost member (country 1) to a low-cost member (country 2 or 3). This is an example of trade creation.

If, for example, country 1 will levy a tariff of 100% on product X, then it will buy it from country 3, which is the low-cost producer in this case. If country 1 enters a customs union with country 2, then country 1 will buy product X from country 2 (selling at 30), not from country C (selling at 50). The direction of trade has therefore shifted from an originally low-cost non-member country (country 3) to a high-cost member country (country 2). This is an example of trade diversion.

We can see that the whole issue of customs union can be disentangled in the free trade-protection argument. As Salera¹² points out that, the main purpose of any customs union is to shift sources of supply. The customs unions are considered a movement towards free trade, if this shift is from a high-cost to a low-cost source. However, if the shift is in the different direction, then customs union may become a device for making tariff protection more effective.

¹⁰ Meade, J. E. (1955). *The theory of customs unions*. Amsterdam: North Holland.

¹¹ Lipsey, R. G. (1957). The theory of customs unions: Trade diversion and welfare. *Economica. New Series*, 24 (February).

¹² Salera, V. (1951). Review of The customs union issue, by Jacob Viner. *The Journal of Political Economy*, 59 (1).

Viner announced that trade creation raises the home country's welfare, while trade diversion lowers it¹³.

Viner also agreed that size does matter¹⁴. He identified economies of scale, where the larger the economic area of the customs union, the more likely is a customs union to operate in the free trade direction.

Viner has concluded that customs unions are unlikely to provide more economic gains than harm, unless strict circumstances prevail¹⁵. In this case, Kreps didn't agree with Viner's general conclusion concerning customs union, because it is rather negative¹⁶.

The idea that supported this conclusion is that trade-diverting effects of customs union can outweigh their trade-creating effects, even if the resulting union tariff is lower than the average level of the previous tariff¹⁷. Viner in his conclusion calls for worldwide non-discrimination of trade barriers.

According to Viner's theory, countries are motivated to integrate if integration is likely to produce static gains more than losses (trade creation more than trade diversion).

Many developments have been made to the Viner static analysis of economic integration effects. The following is the summary of the major developments.

Trade expansion or trade creation and diversion

Meade has admired but criticized Viner's notion of trade diversion where a customs union may actually lead to misallocation of the world's resources¹⁸. He argued that analysis of Viner is only true when there are conditions of inelastic demand and completely elastic supply. He concludes that a customs union can actually increase the volume of trade even though there is trade diversion if demand will be more elastic. Meade named this effect as "trade expansion". Meade suggests the traditional Viner analysis of trade creation and diversion should be updated by this effect, because in this case trade diversion may not be that harmful¹⁹.

Customs Unions' effects of Production and Consumption

¹³ Viner, J. (1950). *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

¹⁴ Viner, J. (1950). *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

¹⁵ Viner, J. (1950). *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

¹⁶ Kreps, T. J. (1950). Review of The customs union issue, by Jacob Viner. *Annals of the American Academy of Political and Social Science*, 272.

¹⁷ Martin, K. 1951. Review of The customs union issue, by Jacob Viner. *International Affairs*, 27 (1).

¹⁸ Meade, J. E. (1955). *The theory of customs unions*. Amsterdam: North Holland.

¹⁹ Meade, J. E. (1955). *The theory of customs unions*. Amsterdam: North Holland.

Perhaps this development is the most important contribution to the theory of customs unions. Lipsey²⁰ argues that Viner has concluded that trade creation when production shifts from the high-cost source to the low-cost source is "good", while trade diversion is considered the "bad thing" in terms of economic welfare. However, Lipsey thinks this must not be the case, as production and consumption effects both are included in economic welfare²¹. The Viner analysis has concentrated only on the production side and neglected the consumption effect. The illustration of this case is as following: when a customs union is formed, relative prices in the domestic markets of member countries change because of the reduction in tariff barriers between them. These price changes have two effects. A production effect as illustrated by Viner²², and secondly, a consumption effect where union members will obviously increase their consumption of each other's products, while reducing consumption from countries outside the union. The weakness in the analysis of Viner was determined by Sheer²³. Sheer thinks that it is the assumption that consumption is independent of these relative price changes. In other words whether the world production is fixed, there will still be some changes in world consumption due to the relative change in prices. Gehrels gave the identification to the consumption effects as the response of consumers to the drop in import prices caused by the tariff removal²⁴.

Lipsey claimed that Viner's conclusion that trade diversion is a bad thing implies a welfare judgment²⁵. Because by Lipsey²⁶ the first effect "production effect of the union" has been taken into account by Viner, while the second effect "consumption effect of the union" has not. However, a welfare judgment in turn requires the combination of the two effects just mentioned, not only one. Lipsey concludes that the Viner classification of trade creation and trade diversion is fundamental to classify changes in the production effect, but it cannot be used to make judgments regarding the economic welfare of customs unions²⁷. This point of view is shared by other researchers such as Gehrels²⁸, Lipsey²⁹ and Krauss³⁰.

²⁰ Lipsey, R. G. (1957). The theory of customs unions: Trade diversion and welfare. *Economica. New Series*, 24 (February).

²¹ Lipsey, R. G. (1957). The theory of customs unions: Trade diversion and welfare. *Economica. New Series*, 24 (February).

²² Viner, J. (1950). *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

²³ Sheer, A. (1981). A survey of the political economy of customs unions. *Law and Contemporary Problems*, 44 (3).

²⁴ Gehrels, F. (1956-1957). Customs union from a single-country viewpoint. *The Review of Economic Studies*, 24 (1).

²⁵ Lipsey, R. G. (1960). The theory of customs unions: A general survey. *The Economic Journal*, 70 (279).

²⁶ Lipsey, R. G. (1957). The theory of customs unions: Trade diversion and welfare. *Economica. New Series*, 24 (February).

²⁷ Lipsey, R. G. (1957). The theory of customs unions: Trade diversion and welfare. *Economica. New Series*, 24 (February).

²⁸ Gehrels, F. (1956-1957). Customs union from a single-country viewpoint. *The Review of Economic Studies*, 24 (1).

²⁹ Lipsey, R. G. (1960). The theory of customs unions: A general survey. *The Economic Journal*, 70 (279).

³⁰ Krauss, M. B. (1972). Recent developments in customs union theory: An interpretive survey. *Journal of Economic Literature*, 10 (2).

Lipsey³¹ argued that this distinction of the production effect and consumption effect of customs unions is misleading because consumption changes in themselves will stimulate production changes. Therefore, he suggested different distinction that is between "inter-country substitution" and "inter-commodity substitution". Inter-country substitution is the situation when one country is substituted by another as Viner's original trade creation and diversion analysis explains. While, inter-commodity substitution is when one commodity is substituted by another as a result of the relative price change.

Trade-Diversion and Welfare

Cooper and Massell³², Johnson³³, and Pomfret³⁴ summarized the implications of the issue of production and consumption effects of a customs union in simple words. Johnson³⁵, suggests that trade-diversion may be welfare-increasing if we take into account both production and substitution effects, in the sense that the welfare losses resulting from the diversion to a high-cost supplier country may be more than outweighed by the welfare gains resulting from the reduced prices to consumers due to the elimination of tariff on imports. Pomfret³⁶ argues that this results in increased consumer surplus whether or not the increased imports were from the least-cost supplier.

Secondary effects

Meade³⁷ gave another development to the Viner study, which is cited in his work as the idea that Viner's analysis was concentrated on the effect from tariff reduction on a single commodity. Meade³⁸ according to Hawtrey³⁹ argues that additional welfare may be gained if we consider the secondary effects on complements and substitute goods. He cites the example of Holland reducing its duty on imports of beer from Belgium, while the duty on beer from other countries remains unchanged. Meade⁴⁰ according to Hawtrey⁴¹ argues that one must trace out the repercussions of this tariff reduction of a single commodity on all the quantities of all the products traded internationally to be able to assess the actual effect of this change on economic welfare of the country.

Tariff reductions

³¹ Lipsey, R. G. (1960). The theory of customs unions: A general survey. *The Economic Journal*, 70 (279).

³² Cooper, C. A., Massell, B. F. (1965). A new look at customs union theory. *The Economic Journal*, 75 (300).

³³ Johnson, H. G. (1975). A note on welfare-increasing trade diversion. *The Canadian Journal of Economics*, 8 (1).

³⁴ Pomfret, R. (1997). *The economics of regional trading arrangements*. Oxford: Clarendon Press.

³⁵ Johnson, H. G. (1975). A note on welfare-increasing trade diversion. *The Canadian Journal of Economics*, 8 (1).

³⁶ Pomfret, R. (1997). *The economics of regional trading arrangements*. Oxford: Clarendon Press.

³⁷ Meade, J. E. (1955). *The theory of customs unions*. Amsterdam: North Holland.

³⁸ Meade, J. E. (1955). *The theory of customs unions*. Amsterdam: North Holland.

³⁹ Hawtrey, R. (1956). Review of The theory of customs unions, by J. E. Meade. *The Economic Journal*, 66 (262).

⁴⁰ Meade, J. E. (1955). *The theory of customs unions*. Amsterdam: North Holland.

⁴¹ Hawtrey, R. (1956). Review of The theory of customs unions, by J. E. Meade. *The Economic Journal*, 66 (262).

Lipsey and Lancaster made a big contribution to the Viner's static analysis, where they discussed about small and large tariff reductions in a customs union⁴². They suppose that a small reduction of tariffs must raise welfare, while a large reduction may raise or lower it.

In the case of gradual tariff reductions Lipsey and Lancaster⁴³ dealt with the consequences of reducing tariffs in stages. They decided that initial stages of tariff reductions raise welfare, while final stages lower it, depending on the specific conditions assumptions made in their study.

The Terms of Trade effect

Krauss⁴⁴ argued that studies analyzing the welfare impacts of economic integration so far have assumed that the country at question is a small country with no effect on world prices. However, this may not always be true. If the country is large enough to change world prices, and if this country levies a tariff, it will reduce the demand for imports and will therefore cause the prices of those imported goods to fall in world markets relative to its exports, and thus improving its terms of trade. This process is known as the terms of trade effect. Krauss⁴⁵ argued that allowing for the terms of trade effect, will dramatically alter the perspective of the analysis.

Competitive vs. Complementary countries and their integration

Viner⁴⁶, Meyer⁴⁷, and Lipsey⁴⁸ claimed that gains will arise between member-countries of a union when they are producing the same commodity. Some economists, such as Makower and Morton⁴⁹, claimed that the gains will be larger the larger is the difference between the costs at which the same commodity is produced in the countries of the union, under the condition of fixed demand. Meyer⁵⁰ gave definition of complementary goods as where the consumption of one good enhances the satisfaction yielded by the other. While, competitive goods are where the consumption of one good is a substitute for the other, diminishing the satisfaction it can provide. An example is brush and paint, in comparison to chocolate ice cream and vanilla ice cream.

⁴² Lipsey, R. G., Lancaster, K. (1956-1957). The general theory of second best. *The Review of Economic Studies*, 24 (1).

⁴³ Lipsey, R. G., Lancaster, K. (1956-1957). The general theory of second best. *The Review of Economic Studies*, 24 (1).

⁴⁴ Krauss, M. B. (1972). Recent developments in customs union theory: An interpretive survey. *Journal of Economic Literature*, 10 (2).

⁴⁵ Krauss, M. B. (1972). Recent developments in customs union theory: An interpretive survey. *Journal of Economic Literature*, 10 (2).

⁴⁶ Viner, J. (1950). *The Customs Union Issue*. New York: Carnegie Endowment for International Peace.

⁴⁷ Meyer, F. V. (1956). Complementarity and the lowering of tariffs. *The American Economic Review*, 46 (3).

⁴⁸ Lipsey, R. G. (1960). The theory of customs unions: A general survey. *The Economic Journal*, 70 (279).

⁴⁹ Makower, H., Morton, G. (1953). A contribution towards a theory of customs union. *The Economic Journal*, 63 (249).

⁵⁰ Meyer, F. V. (1956). Complementarity and the lowering of tariffs. *The American Economic Review*, 46 (3).

Meade⁵¹ suggested that if the partner countries are competitive but potentially complementary, if the initial tariff levels were very high, and if each partner is the principle supplier to the other partner of the traded products in this case a customs union may be welfare increasing⁵².

Dynamic vs. Static analysis of integration

In addition to Viner static analysis Balassa⁵³, and Cooper and Massell⁵⁴ introduced the concept of dynamic effects of economic integration. This analysis added a new dimension to this area of study. The dynamic theory of economic integration proved that the trade creation and trade diversion in static analysis are simply not enough to fully capture and analyze welfare gains from economic integration.

According to Allen⁵⁵, the principle dynamic effects of integration were listed by Balassa⁵⁶ as economies of large-scale, technological change and the impact of integration on market structure and competition, productivity growth, risk and uncertainty, and investment activity. Brada and Mendez⁵⁷ integration is assumed to raise investment and reduce risks. Schiff and Winters summarized the definition of the dynamic effects of economic integration schemes as anything that affects the country's rate of economic growth over the medium term⁵⁸.

Old regionalism vs. new regionalism.

A number of recent studies have referred to the static effects and developments of the theory of economic integration so far (Viner and developments) as "old regionalism", while "new regionalism" is represented by dynamic effects such as increased competition, investment flows, economies of scale, technology transfer, and improved productivity⁵⁹.

Goldstein⁶⁰ argues that integration agreements are now about much more than merely reducing tariffs and quotas.

⁵¹ Meade, J. E. (1955). *The theory of customs unions*. Amsterdam: North Holland.

⁵² Hillmann, H. C. (1956). Review of *The theory of customs unions*, by J. E. Meade. *International Affairs*, 32 (4).

⁵³ Hosny, Amr Sadek (2013). *Theories of Economic Integration: A Survey of the Economic and Political Literature*. *International Journal of Economy, Management and Social Sciences*, 2(5).

⁵⁴ Cooper, C. A., Massell, B. F. (1965). A new look at customs union theory. *The Economic Journal*, 75 (300).

⁵⁵ Allen, R. L. (1963). Review of *The theory of economic integration*, by Bela Balassa. *Economic Development and Cultural Change*, 11 (4).

⁵⁶ Hosny, Amr Sadek (2013). *Theories of Economic Integration: A Survey of the Economic and Political Literature*. *International Journal of Economy, Management and Social Sciences*, 2(5).

⁵⁷ Brada, J. C., Mendez, J. A. (1988). An estimate of the dynamic effects of economic integration. *The Review of Economics and Statistics*, 70 (1).

⁵⁸ Schiff, M., Winters, A. (1998). Dynamics and politics in regional integration arrangements: An introduction. *The World Bank Economic Review*, 12 (2).

⁵⁹ Sheer, A. (1981). A survey of the political economy of customs unions. *Law and Contemporary Problems*, 44 (3).

⁶⁰ Goldstein, A. (2002). *The new regionalism in Sub-Saharan Africa: More than meets the eye? OECD Development Center policy Brief no. 20*. France: Organization for Economic Co-operation and Development.

Current forces driving integration.

Lawrence⁶¹ pointed out that the driving forces of the current integration developments have a radical difference from those driving previous waves of regionalism. Issues of private sector participation, competition, foreign direct investment (FDI), and the increased importance of services all contributed to changing the scenes from those that prevailed during the Viner and following near period.

Economies of scale.

Economies of scale – reductions in inputs per unit of output – result from the efficient use of factors of production at large outputs. This concept was firstly introduced by Corden⁶² in the customs union theory. Balassa⁶³ argue that small markets increase costs, limit the extent of product specialization, reduce competition, and lessen the incentives for technological improvements.

Investment creation and Investment diversion.

When investment barriers are removed, investment creation according to Dee and Gali⁶⁴ is the case when production is moved from a high-cost source to a lower-cost source in the union. Investment diversion occurs when production is moved from a low-cost non-member country to a higher-cost member country of the union because of the PTA.

An interesting fact according to Lawrence⁶⁵ is that the private firms support current wave of integration. This can be seen from the case of the NAFTA, where the US Chamber of Commerce in the United States of America, and the Canadian Manufacturers Association in Canada were the main supporters of the conclusion of this trade agreement.

The world services sector has been booming both in terms of contribution to world trade and world GDP.

FDI in services has been growing more rapidly than in goods⁶⁶. As manufacturing firms move to other countries, other services firms providing complementary inputs and services such as banking, advertising, and transporting accompany them. The rising importance of the services

⁶¹ Lawrence, R. (1996). Preferential trading arrangements: The traditional and the New. *Working Paper Series (The Egyptian Center for Economic Studies)*, no. 6.

⁶² Corden, W. M. (1972). Economies of scale and customs union theory. *The Journal of Political Economy*, 80 (3).

⁶³ Balassa, B. (1975). Economic integration among developing countries. *Journal of Common Market Studies*, 14 (1).

⁶⁴ Dee, P., Gali, J. (2003). The trade and investment effects of preferential trading arrangements. *NBER Working Paper*, no. 10160. Cambridge, Massachusetts Avenue: National Bureau of Economic Research

⁶⁵ Lawrence, R. (1996). Preferential trading arrangements: The traditional and the New. *Working Paper Series (The Egyptian Center for Economic Studies)*, no. 6.

⁶⁶ Lawrence, R. (1996). Preferential trading arrangements: The traditional and the New. *Working Paper Series (The Egyptian Center for Economic Studies)*, no. 6.

sector has significantly changed the world economic environment and created new incentives of integration.

Direct investment nowadays is growing faster than trade⁶⁷. Foreign direct investments are considered as a major impulse for countries to integrate, especially among developing countries, because of its link with exports and economic growth.

Shams suggested that FDI create more scope for mutual trade and increase the degree of market interpenetration⁶⁸. FDI to the integrated region will increase by the formation of an economic integration scheme itself⁶⁹.

Regarding the link between FDI and economic growth, studies have proved that increased investments and more rapid technological change because of integration may significantly contribute to the economic growth of member countries. This argument can be especially important to the case of developing countries, where FDI is used by developing countries as a way through which can modernize⁷⁰.

Conclusion of the Dynamic Theories of Economic Integration

Old and new regionalism refer to static and dynamic theories of economic integration. According to the studies because of the recent changes in the world economy, the dynamic effects of economic integration have recently emerged as a result. But other analysts suppose that static economic integration theories of Viner could be useless in the case of developing countries.

2. European Union as a model of regional economic integration

When there is a discussion about economic integration, the example of the European Union is a necessary point of reference.

European Union has a long history, wide scope, continuing deepening, and successive enlargements. The European Union is taken as a model of regional integration very often. Many regional groupings use the Union as an example to be followed by other. However, this example is not considered in the short-run, because there are many unfavorable circumstances and condition prevailing on the territory of the region, but as an ultimate goal to achieve in the long

⁶⁷ Ethier, W. (1998). The new regionalism. *The Economic Journal*, 108 (449).

⁶⁸ Shams, R. (2003). Regional integration in developing countries: Some lessons based on case studies. *HWWA Discussion Paper, no. 251*. Hamburg, Germany: Hamburg Institute of International Economics.

⁶⁹ Inotai, A. (1991). Regional integration among developing countries, revisited. *Policy, Research, and External Affairs Working Paper, no. 643*. Washington, D.C.: World Bank.

⁷⁰ Schiff, M., Winters, A. (1998). Dynamics and politics in regional integration arrangements: An introduction. *The World Bank Economic Review*, 12 (2).

term. In other regions, the European integration experience is assumed as an "anti-model"⁷¹, a form of deeper integration than the one, which is pursued by other countries. In any case, regional integration initiatives across the world are compared with the European example.

The European Union, for its part, has since a long time been in favor of regional integration its neighbors or in other parts of the world. The European Union has often provided support to such initiatives, and over the last decade has entered formal political and economic cooperation agreements with some regions.

The most important principles of the success of the European Union project include⁷²:

– Robert Schuman of France and Konrad Adenauer of Germany, who conceived of a new form of politics based on the supranational "community method" instead of the traditional balance-of-power model.

–Paris and Berlin remain the driving force behind European integration because of leadership generated by the Franco-German axis through the history of the Europe.

– The readiness of the governments to share sovereignty and build strong, legally based, common institutions to look after the integration project.

–The European Union approach, which is based on the policy of with solidarity and tolerance. It rejects isolation of any member of the union whether they have problems or not. The Union's will to move forward with laws and policies only after the high majority of the country-members are ready. A willingness to provide significant financial aid to poor states of the union to help them achieve the stability.

There are three key economic achievements of the European Union⁷³

➤ The creation of a single market in which capital, goods, services and people move almost without any border and non-tariffs barriers. Market liberalization and the adoption of a common system of regulation have a big progress. This was one of the reasons of the deeper integration over the recent years. Firms and investors now can develop wide strategies and accelerate the development of trade and financial flows, which will lead to higher efficiency, as well as, to the economies of scale.

⁷¹ Bilal, Sanoussi. (2007). *"Is the EU a Model of Regional Integration?" Risks and challenges*. European center for development policy management.

⁷² Fraser, Cameron. (2010). *The European Union as a Model for Regional Integration*. Working Paper. New York: Council on Foreign Relations, Inc.

⁷³ Verbeken, Dirk. *Study on Regional Economic integration in Asia and Europe*. Economic affairs within the Asian and Latin-American countries and within Russia and the new independent state. European commission. Directorate general economic and financial affairs.

➤ The creation of an economic and monetary union. The creation and adoption of a single currency accelerated and consolidated the single market. For the financial sector, it acted as a strong push for further structural change. The introduction of the euro has accelerated the advent of deeper and more unified European financial markets.

➤ The development of an efficient system for policy co-ordination. After the adoption of the euro, there was a conclusion that there is the need to follow prudent macroeconomic policies and implement structural reforms in the markets for goods, labor and financial products. The country-members of the European Union have successfully created a comprehensive set of methods and procedures for co-ordination of the policy.

There have been several efforts to create regional integration similar to the European Union. Among them, there are the Association of South East Asian Nations (ASEAN), African Union (AU), Gulf Cooperation Council (GCC), and Mercosur in South America. But unfortunately or not these structures of the regional integration have all failed to create anything resembling the same result as the members of the European Union. The Association of South East Asian Nations is the most advanced of these tries. It regularly sends people to seek ideas and learn from the EU experience. ASEAN is a strictly intergovernmental body but there is no glimpse of interest in sovereignty sharing, which could be one of the reasons of the failure. It is a similar situation everywhere: there is no other regional body, which is anywhere near the European Union not integration but in political or economic cooperation. The basic requirements of integration are dealing with historical reconciliation and development of the necessary political will. No grouping has even gotten in terms of this requirement. There have been many announcements from groupings in Asia, Africa, the Middle East, South and Central America about the readiness and desirability of making the cooperation closer and even the possibility of integration, but the words have not been made in reality and matched by action.

As was showed above the European Union's historical reconciliation is an important principle⁷⁴ in creating the political will for cooperation and integration. The fundamental step to the success of the EU is the historical reconciliation between France and Germany⁷⁵. The reconciliation was attained by the leaders of both countries through the years of hard political struggles and efforts. There has been no efforts to reach such an agreement among the countries seeking for integration. For example, East Asian integration is far from reality without reconciliation between Japan and China, as well as between Japan and Korea. The similar

⁷⁴ Fraser, Cameron. (2010). *The European Union as a Model for Regional Integration*. Working Paper. New York: Council on Foreign Relations, Inc.

⁷⁵ Fraser, Cameron. (2010). *The European Union as a Model for Regional Integration*. Working Paper. New York: Council on Foreign Relations, Inc.

situation unresolved problems, absence of the trust and deep suspicions between, for example, Pakistan and India, Argentina and Brazil. These examples and experience of the European integration show that the historical reconciliation is a necessary point for countries to proceed through the many stages required to create a free trade area, a customs union, a single market, a single currency, a common passport area and a common foreign policy.

While the European Union was severely disturbed by the recent economic crisis. The most developed example of regional integration began the increase doubts about the integration process. The structural and institutional weaknesses⁷⁶ of the European Union, such as budgetary and economic imbalances, functional weaknesses of the European Union's structure and defects in the supervisory procedures and economic policies' co-ordination, were revealed by the financial crisis. The crisis has temporarily weakened the European Union's status as a model for regional integration, but as the EU recovers its confidence, as it always has after previous crises, it will continue to be the leading example for other efforts at regional integration⁷⁷.

3. Problems of the integration in Central Asia

Integration is a process of interaction and convergence of national economies, the formation of groups of regional economic character. The groups are based on the processes of interdependence of national economies in order to eliminate national barriers of trade and investment cooperation, production of business entities on equal conditions. A single economic space is created on the basis of harmonization, unification and harmonization of budget and tax policies, monetary system⁷⁸.

In the recent years problems of economic integration attracted the attention of foreign and domestic scientists. Early links of economic integration between certain countries were characterized as military-political alliances and mainly affected the military-industrial complex⁷⁹.

In the current period of globalization Central Asian region with its rich natural resources and an important strategic position quickly became the center where the economic and political interests of the world powers intertwined. Countries of the region have difficulty to enter into

⁷⁶ Sikora, Justyna. (2011). Economic governance in the European monetary union - weaknesses revealed during the crisis 2007–2009 and direction of reforms. *Finanse, rynki finansowe, ubezpieczenia*, Nr 43.

⁷⁷ Fraser, Cameron. (2010). *The European Union as a Model for Regional Integration*. Working Paper. New York: Council on Foreign Relations, Inc.

⁷⁸ Smagulova, D. (2012). Integrational processes in the Central Asia: problems and prospective. *Eurasian economic integration*, 4 (17).

⁷⁹ Tinasilov, M. D. (1999). *Problems of the economic integration of the countries of the Central Asia in transfer economy*. Dissertation.

international politics due to a number of factors, one of which is the lack of experience and the need to balance between the centers of power in accordance with the interests of the country.

On the territory of the former Soviet Union, there are various opinions about the future and fate of the Commonwealth of Independent States (CIS) development recently. One of the experts believes that this form of integration is outdated and its effectiveness is zero. As the evidence, they cite the amount of unrealized agreements and treaties adopted by the co-development programs, such as Organization for Democracy and Economic Development (GUAM), the Organization of Central Asian Cooperation (OCAC), Eurasian Economic Community (EurAsEC), where almost put the same tasks as in the CIS.

During 15 years there were 1500 documents that constitute the legal framework of relations. Not less than 2/3 of the documents were adopted at the beginning of the CIS⁸⁰. This is a consequence of the former Soviet republics have tried to resolve the problems associated with the division of property, debt, and assets of the USSR. The problems were acute and tension sometimes appeared between the former "brothers". But the foundation of CIS allowed to avoid the Balkan scenario.

On the other side, some of the documents remained in theory, because the countries had no real basis for their implementation.

The new agreements are also with different problems. The reason is that national laws have different bases and support the interests of their own states. These interests often do not have a common ground.

In this regard, many analysts, mostly western, suspiciously look at the current trends in the post-Soviet area. They think that the collapse of the CIS as inevitable as it happened with the Soviet Union. The bright trend are "blocks", a visa-free regime, fanning of the situation in the border problems (difficulty of demarcation and delimitation).

Meanwhile, there are new calls to create an economic union. This initiative was made by the president of Kazakhstan Nursultan Nazarbayev. He suggested to organize a union in Central Asia⁸¹. This caused confusion among the neighbors. The reason is the existence of the Organization of Central Asian Cooperation (OCAC), the Commonwealth of Independent States, the Shanghai Cooperation Organization (SCO) and the Eurasian Economic Community

⁸⁰ Mahmudov, A. (2005). *CIS: Integration in different forms*. Retrieved from: <http://www.centrasia.ru/newsA.php?st=1120834680>

⁸¹ Mahmudov, A. (2005). *CIS: Integration in different forms*. Retrieved from: <http://www.centrasia.ru/newsA.php?st=1120834680>

(EurAsEC), but a little has been achieved by these structures, so what is the point to form new alliances with unclear objectives.

However, the Commonwealth of Independent States has a future, it all depends on how active the creators and participants of the Commonwealth will be in the integration. This will lead to the situation when the cooperation will become irreversible.

Economic integration is generally considered as a deepening of cooperation between states.

Countries may create all sorts of conditions and the most favorable economic climate, but work together will only with bordering countries or neighbors.

The following number of factors determines role of the Central Asian region⁸²:

1. Geographical location of the region has a strategic importance in relation to the impact on stability and security of a big part of the Eurasian continent;

2. Concentration of natural resources in Central Asian, especially hydrocarbons, draws big attention of many of the leading countries of the world to the region, because the control over the fuel and energy resources management and transportation gives an influence on the region and the world market;

3. Central Asia lies on the intersection of the transportation corridors of Eurasia and has a broad transportation and communications network.

There are also positive trends in regional cooperation⁸³:

1. There are concluded agreements of eternal friendship, cooperation and mutual assistance between Kazakhstan, Kyrgyzstan and Uzbekistan. This indicates the formation of the legal framework for the development of integration and cooperation in the Central Asia.

2. In order to implement the Treaty of the establishment of a single economic space, there were created an organizational structure for deepening cooperation between the countries. The structure is the Interstate council, which includes the heads of the countries, the councils of the prime ministers, ministers of foreign affairs and defense.

However, the unresolved issues remains:

1. The lack of mechanisms for the implementation of the decisions. There is an inequality of positions of the member-countries in the Central Asia and the Commonwealth of Independent States. Documents are only advisory in nature.

⁸² Smagulov, K. E. (2010). *The integration of countries of Central Asia and the factor of external geopolitical players*. Retrieved from: <http://www.contur.kz/node/1218>

⁸³ Shaltykov, A. I. (2012). *Prospective of the integration of the Central Asian countries* Retrieved from: http://www.rusnauka.com/22_PNR_2012/Politologia/1_115293.doc.htm

The problematic question is the rational use of water and energy resources in the Central Asian region.

After the gain of independence in the economic development, the gap between the countries of Central Asia increased. Moreover, the question about the use of water resources arose. The disputes over the water resources in the Central Asia focused on three issues. There is a rapid economic development in Kazakhstan, Uzbekistan, and Turkmenistan. The mainstay is the energy production and improved industrial system. At the same time, Tajikistan and Kyrgyzstan, located in the upper reaches, are busy with solving problems of food and energy crisis. Geographic conditions, limited natural resources put two states in a difficult position. The development of water resources will lead Kyrgyzstan and Tajikistan to the reduction of economic growth, but if the upstream will reduce the supply of irrigation water, the countries in the lower reaches of this will have a serious problem and the negative impact on the economy⁸⁴.

There are three key main questions at the moment. First, the construction of hydroelectric power plants. Tajikistan and Kyrgyzstan are going to build new large hydropower to increase the generating capacity, but Uzbekistan and Kazakhstan expressed dissatisfaction and concern. Second, guarantee of the water supplies for irrigation. Tajikistan and Kyrgyzstan want more of energy compensations from the countries of the lower reaches of rivers, but Uzbekistan and Kazakhstan are against the granting of natural gas, coal and electricity at lower prices because of the debt and other issues. During the winter, there were electricity shortages in Tajikistan and Kyrgyzstan. There was a necessity to flush the water for energy production, which led to a significant reduction of the water reserves. This affected the process of irrigation in the summer season. Third, the protection of the environment. Summer in the Central Asia is arid, because of the climate the environmental situation is very vulnerable. There is also a question of pollution of rivers, which makes the problem of water resources even more pressing.

Use of the water resources is a regional problem to solve and discuss by the countries through negotiations. Over 10 years, the problem of water has been the focus of regional cooperation in Central Asia, which failed to reach an agreement, despite the creation of a number of multilateral mechanisms and committees. The problem continues to generate new conflicts. Parties do not want the compromise they achieved in key economic interests to prevent international cooperation. Therefore, high international prices on energy do not fall. Kazakhstan and Uzbekistan do not want to give free energy to Tajikistan and Kyrgyzstan, which in turn stand for "commercialization" of water resources and going to "sell water" to the downstream

⁸⁴ Kurtov, A. (2013). *Water resources as the reason of the conflicts in the Central Asia*. Retrieved from: <http://svom.info/entry/350-vodnye-resursy-kak-prichina-konfliktov-v-centralno/>

countries. This is why it is so hard to all parties to the dispute to come to a common denominator⁸⁵.

Lack of coordinated actions impedes integration processes.

2. Different level of economic development in Central Asia. Countries in the region have different levels of the economy and the rate of development, which is a limiting factor in the integration cooperation in Central Asia.

3. Inefficient development of a mutual trade in Central Asia. Differences in the scale and pace of economic liberalization, low level of economic interaction between states are the main factors of ineffective development of the mutual trade.

Note that the Central Asian economies in many positions complement each other, which makes it possible to extend the commodity nomenclature of the mutual trade in Central Asia.

4. Irregular migration of the population of Central Asia⁸⁶.

There are serious problems in the Central Asian region because of the presence of significant human and natural resources. Negative impact of drug trafficking, extremism, illegal migration to other countries is a major concern of the international community and requires a coordinated policy in Central Asia.

To do this there is a need in further deepening of regional and international cooperation. However, the real integration capabilities are currently small because narrow national interests prevail in the region, while the haphazard and inadequate economic reforms increasingly cause disintegration⁸⁷.

Therefore, the relationships between some the countries in the region (Kazakhstan and Uzbekistan, Tajikistan and Uzbekistan) are relatively intense instead of brotherly or friendly. However, there is a development of programs and their options for integration development under the influence of globalization processes of the recent years. States in the region are interested in coordinated actions in the region because there are many issues that are relevant and meaningful for each state and the region as a whole. The variety of approaches to the forms of partnerships is not an obstacle for the Central Asian countries to be aware of the importance of strong relationships, which are important for the future development of the Central Asian region.

⁸⁵ Kurtov, A. (2004) *Water conflicts in the Central Asia*. Retrieved from: http://www.observer.materik.ru/observer/N7_2004/7_03.htm

⁸⁶ Ergeshbaev, U. Zh. (2009) Modern labor migration of the Central Asia to Russia. *Scientific journal of the Belgorod State University. Series: History. Politics. Economy. Informatics*. 7 (10-1-1).

⁸⁷ Baydarov, E. U. Central Asia: problems and paradoxes of integration. "Regionology" journal. № 2. Retrieved from: <http://regionsar.ru/node/682>

Currently, it takes the form of bilateral, multilateral agreements on joint actions in the economic, political, cultural and other fields, but the real returns are not great.

The existing barriers of integration have a partial relation to the complex processes of geopolitical, cultural and civilizational self-determination of the countries in the region. The opinions of the countries of the region about the integration processes differ. This is seen in the contrast of social advantages of settled and nomadic cultures, ill feeling between the countries' population to each other, which the growing trend of mutual alienation among the peoples of the region⁸⁸.

Despite the borders of the Central Asian region, the peoples are living in the same cultural and civilizational space, have common traditions, culture, religion and history. It is impossible to share this heritage. The heritage belongs to all people of the region. The understanding of this should send the countries of the region to new ideas of regional integration.

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Malik Borbugulov

Lecturer of World Economy Department

International Ataturk-Alatoo University

Bishkek, Kyrgyz Republic

Tel.: +996 553 1342 15

Email: malik.borbugulov@iaau.edu.kg

bismark1990@gmail.com