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## European Union and Eurasian Economic Union trade relations and their impact on Kazakhstan

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### Abstract

*Kazakhstan, Russia and Belarus have signed the Agreement for creation the Eurasian Economic Union since the 1 of January, 2015. The basics of new economic union are free goods and services, labor and capital movement. The union is being strongly criticized as the union of similar economies. European Union is the biggest trade partner of Russia as well as Kazakhstan. But the new Eurasian Economic Union begins to start its activity with the political and military conflict in Ukraine which became the reason of economic sanctions against Russia and Russian embargo against EU. This leads to trade obstacles not between EU and Eurasian Economic Union, but to trade distortions within Eurasian Economic Union. The paper examines the economic challenges for Kazakhstan as the member of Eurasian Economic Union taking into account turbulent period of its main trade partners and its economic structure and shows the bilateral significance of bilateral relations between European Union and Eurasian Economic Union.*

Keywords: Eurasian Economic Union, European Union, cooperation, trade, investment

### 1. Introduction

In 2014, Kazakhstan, Russian Federation and Belarus signed the Agreement for creation of new Eurasian Economic Union (EEU) which will come in force starting from 2015. This was the final result of long unsuccessful attempts for creation Post-Soviet economic integration.<sup>1</sup>

Since the period of independence bilateral relations of Former Soviet Union (FSU) countries and European Union (EU) increased significantly. EU became the source of foreign aid and foreign direct investment (FDI). EU also initiated a several number of projects aimed to promote the transition from centrally planned to market economy. FDI from European countries to CIS

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<sup>1</sup> The independent history of Post-Soviet republics is characterized not only by different integration agreements such as Commonwealth of Independent States (CIS, 1991), Central Asian Economic Community (1998), the Eurasian Economic Community (EurAsEC, 2000), or Central Asian Cooperation Organization (2002), but with signing agreements in security and peace integration as Conference on Interaction and Confidence Building Measures in Asia (CICA) or the Collective Security Treaty Organization (CSTO), agreements on ecological integration as the International Fund for Saving the Aral Sea, linguistic and cultural integration as The Cooperation Council of Turkic Speaking States (CCTS), integration based on religion as Islamic Cooperation Organization. For details on Central Asian integration see Pomfret, 2009.

economies went mainly in energy resources. Russian Federation and Kazakhstan are the holders of huge stocks of raw materials such as natural gas and oil. The increasing natural resources prices since 2000 had positive influence on both Russia and Kazakhstan. Both countries established stable economic growth, improved institutions and increased social well-being.

But creation of the Eurasian Economic Union and establishment of common external tariffs (CET) with simultaneous political crises between Europe and Russia is going to dramatically change the economic relations between EU and EEU. Mutual sanctions tend not only to decrease the volume of interregional bilateral trade, but also decrease intraregional trade volumes due to slowdown of Russian economy and its high interdependence with integration partners.

The goal of the paper is to analyze the bilateral economic relations between EU and newly created EEU. Section 2 analyses the background of relations between EU and FSU (mainly EEU members). Section 3 analyses the structure of bilateral trade and investment relations between EU and EEU. The last section offers some recommendations.

## **2. Background of EU and EEU relations**

Cooperation between the EU-15 and the CIS was built on the basis of bilateral partnership and cooperation agreements (PCAs) negotiated during the 1990s. Nine of these entered in force between 1997 and 1999. The PCAs offered little in the area of economic integration: the most-favored nation clause; some sectoral, legal, and institutional cooperation in such areas as transportation, energy, and competition policy; some legal harmonization in the areas of custom law, corporate law, banking law, intellectual property rights, technical standards and certification, and so on. However, cooperation in the area of legal and institutional harmonization suffered from insufficient incentives and inadequate enforcement mechanisms (Dabrowski 2008). The following programs were funded by EU for supporting new independent states: Technical Assistance to the Commonwealth of Independent States (TACIS), the Transport Corridor Europe-Caucasus-Asia (TRACECA), the Interstate Oil and Gas Transportation to Europe (INOGATE).

TACIS aimed to support institutional reforms, economic development (including financial system development), social system reforms, development of infrastructure networks, environmental protection. Created in 1993, TRACECA is an international transport programme financed by EU member states that involves the European Union and 13 states from Eastern Europe, the Caucasus and Central Asia. Originally TRACECA involved the five CA countries<sup>2</sup> and the three Caucasus countries, but it has since been joined by Moldova, Ukraine, Turkey, Romania and Bulgaria. The programme's goal is to support the political and economic independence of these states by facilitating their access to world markets, in particular, European markets. INOGATE is an international energy co-operation programme between the EU and Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. Its main objectives are converging energy markets based on the principles of the EU internal energy market; enhancing energy security by addressing the issues of energy exports/imports, supply diversification, energy transit and energy demand; supporting sustainable energy development; and attracting investment in energy projects of common and regional interest (Laruelle et.al. 2012). All the programmes positively influenced on the development of all beneficiary countries.

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<sup>2</sup> Kazakhstan, Uzbekistan, Tajikistan, Kyrgyz Republic, Turkmenistan

When analysing the trajectory of a new state, it is all but impossible to exclude the impact of external factors on the development of national sovereignties. It is primarily conditioned by the fact that other states, bigger and better established, will always try to assert their influence on the country at its inception. Thus, a small country could certainly be seen as a ‘geopolitical irritant’, if it fails to comply with the demands of its larger, more powerful neighbours. This is the case of Belarus which is geographically situated between two powers, EU and Russia. Taking into account its national interests, the Belarusian government shaped the course towards a maximally close rapprochement with Russia, on the condition that the state sovereignty of Belarus should be preserved<sup>3</sup>. The final outcome of Russia and Belarus relations is the creation of EEU. During the first years of its statehood, Belarus’s relations with the EU were rather promising. Almost all the countries of the European continent recognized Belarus as an independent and sovereign state and established diplomatic relations with it.<sup>4</sup> These progressive trends in the EU–Belarus relationship were interrupted by the political decision of the EU and the USA after the Belarusian referendum of 1996, which was declared undemocratic and a violation of human rights (Rotman et.al. 2011).. During 1996-2006 Belarus was internationally isolated state. In the current period despite the positive changes there is also political tension between EU and Belarus.

Kazakhstan is also geographically located between two powers, Russia and China and negatively affected by its landlockedness. Kazakhstan declared multi-vector foreign policy, and interested in cooperation either with European Union as its biggest trade partner, or with USA. As the newly independent state, it benefited much from the EU programs described above. Bilateral relations between Kazakhstan and the EU are based on a Partnership and Cooperation Agreement (1999), a Memorandum of Understanding on cooperation in the field of energy (2006), a Memorandum of Understanding on cooperation in the field of transport (2009). In 2014 the European Union and the Republic of Kazakhstan successfully concluded the negotiations of the EU-Kazakhstan Enhanced Partnership and Cooperation Agreement. This is an important moment both for the EU and Kazakhstan as the new Agreement will significantly deepen political and economic ties between the two sides for the benefit of the people of both Kazakhstan and Europe. Kazakhstan is the first Central Asian partner to have concluded an Enhanced Partnership and Cooperation Agreement with the EU. The new Agreement will replace the Partnership and Cooperation Agreement in force since 1999, and will give EU – Kazakhstan relations a new up-to-date and stronger foundation.<sup>5</sup>

Russian Federation is the biggest energy supplier to EU. Bilateral relations between EU and Russia are negatively affected by political crises in Ukraine. EU and US sanctions against Russia (areas of capital markets, defense, dual-use goods, sensitive technologies) and Russian response embargo on European agriculture products negatively impact on intraregional EEU trade due to Russian economic slowdown and economic ties between Russia, Kazakhstan and Belarus. This

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<sup>3</sup> To achieve this objective, a Treaty of Friendship, Neighbourliness and Mutual Assistance between the Russian Federation and the Republic of Belarus was signed on 21 February 1995; the Commonwealth of Russia and Belarus was formed on 2 April 1996; the Union Treaty between Belarus and Russia was signed on 2 April 1997; and finally, the main inter-state treaty – the Treaty on the Creation of a Union State of Belarus and Russia – was signed on 8 December 1999

<sup>4</sup> The largest European economies, including Germany and Italy, even lent the country some financial support, especially related to fighting the consequences of the Chernobyl nuclear accident. Western states repeatedly invited Belarusian officials and members of civil society and political parties for educational and training purposes. In those days Belarus’s government was officially developing its new security doctrine, which firmly placed Belarus at the heart of Europe and as part of the European integration process.

<sup>5</sup> EU-Kazakhstan. Enhanced Partnership and Cooperation Agreement.

negative process also creates a number of problems such as the problem of re-export of European agricultural goods through the territory of Belarus and Kazakhstan. The important question to be asked is what are the costs of economic integration in the period of political crises and bilateral sanctions?

### 3. Bilateral trade and investment relations

Comparative statistics of EU and EEU are given in Table 1. EU is the world's biggest economy which produces 22.8% of world's GDP. The share of EEU is only 3.3%. Nominal GDP per capita of EU is more than two times higher than EEU's. The important point of any economic integration is strengthening of trade relations through the increasing of market size. The market size of European Union is three times higher than EEU's. European countries are more industrialized with diversified economies.

Table 1. Selected socio-economic statistics of EU and EEU members, 2013

	Nominal GDP, mln. US doll.	Nominal GDP per capita, US doll.	Real GDP, mln. US doll. (2005=100)	Real GDP per capita, US doll. (2005=100)	Population <sup>a</sup> , mln.
EU-28	17355091 (22.8%)	33916.5	14628177 (30.9%)	28587.4	506
CIS	2819222 (3.8%)	10152.9	1337162 (2.4%)	4815.5	282
EEU <sup>b</sup>	2436924 (3.3%)	14335	1135765 (2%)	6680	170
Russia	2144146	15011.49	995637.7	6970.6	143,3
Kazakhstan	220550.4	13415	93148.2	5665.8	16,9
<b>Belarus</b>	<b>72226.8</b>	<b>7719.274</b>	<b>46979.1</b>	<b>5020.9</b>	<b>9,5</b>

Source: UNCTAD statistics

Note: <sup>a</sup> population data for EU is from EuroStat database, for others – statistical committee of CIS countries; <sup>b</sup> the indicators for EEU are calculated by authors

The feature of EEU members is national economic similarity. Russia and Kazakhstan as the holders of huge stocks of mineral resources are raw materials suppliers for European customers. The share of mineral fuels in the total imports of EU from Kazakhstan is 93.4%, from Russian Federation 77.7%, from Belarus the share is 36.3% (Table 2). Only Belarus has the most diversified exports to European Union. Thus bilateral trade between EU and EEU is mainly based

on energy resources, particular natural gas from Russia and crude oil from Kazakhstan. The share of other products is negligible.

Table 2. Trade flows by SITC section, 2013

	Imports, share in Total, %			Exports, share in Total, %		
	KAZ	RUS	BLR	KAZ	RUS	BLR
Total	100.0	100.0	100.0	100.0	100.0	100.0
Food and live animals	0.5	0.6	2.8	3.2	7.3	9.2
Beverages and tobacco	0.0	0.0	0.5	0.8	1.4	0.7
Crude materials, inedible, except fuels	0.7	1.8	10.2	1.0	1.5	1.4
Mineral fuels, lubricants and related materials	<b>93.4</b>	<b>77.7</b>	<b>36.3</b>	1.2	0.9	0.8
Animal and vegetable oils, fats and waxes	0.0	0.2	1.1	0.1	0.4	0.2
Chemicals and related prod, n.e.s.	1.5	3.1	17.4	18.5	16.8	16.7
Manufactured goods classified chiefly by material	2.5	6.0	21.1	9.1	10.5	13.4
Machinery and transport equipment	0.1	1.0	4.9	<b>51.4</b>	<b>47.4</b>	<b>48.9</b>
Miscellaneous manufactured articles	0.0	0.2	4.0	13.3	12.5	7.3
Commodities and transactions n.c.e.	0.2	1.6	0.2	0.9	0.9	0.8
Other	1.0	7.9	1.6	0.5	0.5	0.5

Source: European Commission data

European Union's export to EEU based mainly in machinery and transport equipment, chemicals and related products, manufactured goods. In this point, several questions arise: why during the two decades of independence little has changed in manufacturing industries in EEU countries? Why has export diversification been hardly possible for them? What are EEU countries going to produce and export? Who is going to be EEU products' customer? To the "classical" well-known explanation like lack of time for rehabilitation after Soviet Union dissolution and several numbers of crises (regional and sub-regional, including Russian crises in the end of 1990) and their influence on region economies, we should add other reasons. We guess that here we should remember the simple economic categories as demand and supply. The standards and quality of finished EEU products are far from European. They also have no preferences in the CIS market. For instance, because of increasing well-being preferences of Kazakhstani population strongly changed since the Soviet period. The local producers' goods are less competitive than imported goods.

The second reason is Chinese factor. The Chinese products are more competitive due to the costs of production. 'Westernisation' of preferences with the simultaneous decrease of local suppliers made the market of Kazakhstan very attractive for importers. All EEU countries have the same situation. The transition period's feature is transformation of local producers to mediators of imported goods from China, Turkey, and Europe. Because of EEU products' quality it is rather difficult to find customers in Europe. Thus, for EEU countries export of fuels shouldn't be a problem. The most important issue is how to spend oil and gas money to improve national systems and manufacturing industries. In the current period it is almost impossible to diversify exports to EU or China. But it is possible to construct manufacturing industries which will

provide by goods and services the internal market of EEU. First of all, EEU is not ready for competition with manufacturing industries of EU (due to EU brands in machinery or chemicals), but it is possible for EU to compete with China to expand their local market control. Despite the existing contradictions the trade flows between EU and EEU are going to expand (Table 3). The share of EEU in extra-EU imports in 2013 is about 14%, in extra-EU exports is about 8%.

Table 3. EEU's share in extra-EU trade flows

	Imports, share in extra-EU, %			Exports, share in extra-EU, %		
	Kazakhstan	Russia	Belarus	Kazakhstan	Russia	Belarus
2003	0.40	7.60	0.2	0.20	4.30	0.3
2004	0.70	8.30	0.3	0.30	4.9	0.3
2005	0.90	9.60	0.3	0.30	5.4	0.3
2006	1.00	10.50	0.3	0.40	6.3	0.4
2007	0.90	10.20	0.3	0.50	7.2	0.4
2008	1.10	11.40	0.3	0.40	8	0.5
2009	0.90	9.70	0.2	0.50	6	0.5
2010	1.00	10.60	0.2	0.40	6.4	0.5
2011	1.30	11.70	0.3	0.40	7	0.5
2012	1.40	12.00	0.3	0.40	7.3	0.5
2013	1.40	12.30	0.2	0.40	6.9	0.5

Source: European Commission data

### Why EU is important for EEU: case of Kazakhstan

In Kazakhstan's international trade EU has the biggest share (Table 4). Due to non-diversified economy of Kazakhstan increasing demand for oil and increasing oil prices since 2000 positively affected its national income. The oil price volatility and the recent oil price drop had negative effect on Kazakhstan. This can be proved by new economic Strategy "Nyrly Zhol" ("Fair Route"), which was proposed by the Presidential message in November 2014 and aims to maintain the economic growth and social development of Kazakhstan since the drop of oil prices and slowdown of Russian economy. Kazakhstan decided to spend the money of National Fund, which accumulates oil revenue. The case of Kazakhstan is not so optimistic. Restrictions of trade and sanctions against Russia cause the economic slowdown of Russia and negatively affects Russian financial sector. The position of Russian currency is also negatively affects on Kazakhstan's currency. After the February, 2014 currency devaluation in Kazakhstan and social tension due to inflation, the Government and National Bank try to keep under control the financial market of Kazakhstan. Response Russian embargo caused the problem of re-export of European agriculture products through Belarus and Kazakhstan. This is also the reason of trade distortions. For Kazakhstan, this turbulent period of regional economy should be the period of re-imagination of the significance of domestic manufacturing industries development and economic diversification. Thus EU has double significance influencing on Kazakhstan directly and indirectly by influencing on its strategic integration and trade partners. Bilateral relations of Kazakhstan and EU are not restricted by trade relations. The European Union is the main source of inward investment for Kazakhstan (Table 5).

Table 4. Foreign trade indicators of Republic of Kazakhstan, 2012-2013

	2012			2013		
	Country's share in total trade. %	Country's share in total exports. %	Country's share in total imports. %	Country's share in total trade. %	Country's share in total exports. %	Country's share in total imports. %
Total	100	100	100	100	100	100
<b>CIS</b>	<b>25.3</b>	<b>13.2</b>	<b>47.7</b>	<b>25.1</b>	<b>12.8</b>	<b>46.5</b>
<b>EEU:</b>	<b>18.0</b>	<b>7.2</b>	<b>38.1</b>	<b>18.4</b>	<b>7.0</b>	<b>38.3</b>
Russia	17.4	7.1	36.6	17.9	6.9	36.8
Belarus	0.6	0.1	1.5	0.6	0.1	1.4
<b>EU:</b>	<b>41.1</b>	<b>52.4</b>	<b>20.1</b>	<b>41.0</b>	<b>53.9</b>	<b>18.6</b>
Austria	3.9	5.7	0.6	3.0	4.3	0.7
Germany	3.9	1.6	8.3	2.2	0.5	5.0
Italy	12.3	17.8	2.1	13.1	19.5	2.1
Netherlands	5.7	8.4	0.6	7.7	11.7	0.8
France	4.7	6.5	1.4	4.9	6.4	2.1
<b>Asia:</b>	<b>24.3</b>	<b>24.1</b>	<b>24.7</b>	<b>25.2</b>	<b>23.8</b>	<b>27.6</b>
China	16.3	16.5	16.1	17.0	17.0	17.1
Japan	1.1	0.6	2.0	1.3	0.7	2.2

Source: Data of Committee of Statistics of Ministry of National Economy of Republic of Kazakhstan

The importance of EU is also characterized by the increasing demand for European institutions. Institutional relations with EU are needed to improve underdeveloped infrastructure, bureaucratic obstacles, corruption, financial sector instability, environmental protection, etc. This is important for attracting the investors not only in energy, but in manufacturing industries to overcome technological backwardness.

### Why Russia is important for Kazakhstan?

According to fuel-dependent economic structure of Kazakhstan, the oil transportation issue is very important. The oil from Kazakhstan goes through pipelines via Russian territory. The crisis in Ukraine shows the significance of pipelines in international trade. There are no oil pipelines through Caspian Sea and Kazakhstan has no direct access to Baku-Tbilisi-Ceyhan (BTC) pipeline. According to Kazakhstan's new national strategy, in 2050 it should be in the list of 30 highly developed countries. In the case of export diversification to Europe and due to project "Western China – Western Europe" the transportation routes also will lead to Russia and Belarus. Border crossings are very expensive due to corruption and bureaucracy. Thus, EEU gives new opportunities for international trade of Kazakhstan.

Table 5 – Inward investment by EEU countries and selected EU countries, mln. US dollars

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Belarus	1.3	0.0	4.7	14.4	27.0	41.7	85.8	122.5	165.0
Russia	226.8	541.1	827.6	965.6	663.6	951.6	1 000.1	1 069.5	1 299.2
Belgium	-5.2	2.8	5.1	62.8	145.0	422.1	405.6	856.6	958.2
Great Britain	603.7	894.4	1 154.9	1 912.3	1 265.2	1 098.0	1 097.3	1 395.7	885.7
Germany	86.5	164.8	221.3	353.0	298.6	201.9	404.4	681.6	409.5
Italy	325.6	381.6	521.7	699.4	685.1	648.0	484.7	866.0	564.0
Netherlands	1 944.1	2 990.7	3 267.0	4 411.5	7 470.2	7 310.3	8 876.0	8 692.2	6 538.6
France	774.9	802.3	1 026.8	1 206.5	1 351.2	1 561.4	1 571.3	1 168.7	954.0

Source: Data of National Bank of Republic of Kazakhstan

### Why EEU is important for EU?

Discussions about the economic significance of EEU as the equal trade partner for EU are far from reality. But Europe needs energy resources from EEU despite attempts to diversify its energy policy. Russia remains its important role for EU energy market (Table 6). The plenty of papers dedicated for the issue of EU – Russia energy relations. Van Der Meulen (2009) argued that EU energy policy towards Russia damages security of supply because it neglects the specific aims and propensities of Russia and Gazprom. Schmidt-Felzmann (2011) analysed EU member states' choices to ensure domestic supply security by either increasing gas supplies from Russia or by reducing gas imports from Russia. Fernandez (2011) analysed the various channels through which the Russian government and the state-owned Gazprom enterprise have sought to undermine the Nabucco pipeline's options: strengthening their position in Central Asia, proposing construction of Southstream and taking control of the Central European Gas Hub (CEGH) in Baumgarten (Austria). Author showed that Russia has developed an export strategy that has 'indirectly' given an effective response to the project, leaving it in a considerably weakened position. Cwiek-Carpowicz (2012) examined the main problems of Russia's gas sector in the context of the shale gas revolution and the liberalization of the EU gas market and analysed the perspectives of Russia's energy relations with EU countries and formulates some recommendations for them. Kratochvil and Tichy (2013) explored dominant interpretations of the EU–Russian energy relations by identifying three dominant concepts around which these interpretations revolve: integration, liberalization and diversification.

But the political role of Russia is more important than economic. Russia plays one of the leading roles for the solution of political and military crises in Ukraine, Middle East and Islamic State. Russia and Kazakhstan play significant role for keeping Central Asia stable and preserving the region from different conflicts. Except the economic relations, where EU dominates, there are bilateral relations on political and other important issues where EEU plays also important role. Thus, the cooperation between EU and EEU is inevitable.

Table 6. Share in Extra-EU-28 imports of petroleum oil, crude and NLG, main trading partners, 2013

Partner	Value (Share %)	Net mass (Share %)
Russia	33	34
Norway	11	11
Nigeria	9	8
Saudi Arabia	8	8
Kazakhstan	7	6
Libya	6	6
Algeria	5	5
Azerbaijan	5	4
Iraq	3	4
Angola	3	3
Mexico	2	2
Equatorial Guinea	1	1
Egypt	1	1
Kuwait	1	1

Source: Pongas et.al. (2014)

#### 4. Conclusions

Cooperation between EU and the EEU was built on the basis of bilateral partnership and cooperation agreements (PCAs) negotiated during the 1990s after dissolution of Soviet Union. EU has funded different programs supporting the transition of newly independent post-Soviet countries from centrally-planned to market economy.

In Kazakhstan's international trade EU has the biggest share. Restrictions of trade and sanctions against Russia cause the slowdown of Russian economy which negatively affects on Kazakhstan (including the risk of the next currency devaluation). Response Russian embargo caused the problem of re-export of European agriculture products through Belarus and Kazakhstan. Thus EU has double significance influencing on Kazakhstan directly and indirectly by influencing on its strategic integration and trade partners. Bilateral relations of Kazakhstan and EU are not restricted by trade relations. The European Union is the main source of inward investment for Kazakhstan.

EU and EEU are not equal trading partners. But EU is dependent not only the energy resources. The geopolitical role of Russia is more important than economic. Russia plays one of the leading roles for the solution of political and military crises in Ukraine, Middle East and Islamic State. Russia and Kazakhstan play significant role for keeping Central Asia stable and preserving the region from different conflicts. Thus, the cooperation between EU and EEU is inevitable. Therefore, there is a need for new separate bilateral partnership and cooperation programs and agreements between EU and EEU, which might become the solution for a big number of conflict issues.

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