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Integration of Financial Markets under the Conditions of the Eurasian Economic Union: Challenges and Opportunities

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Abstract:

The focus on the regional financial integration became a center of attention due to enhancement of cooperation among member states the Eurasian Economic Union and sustainable development. However, the reality of global experience demonstrated that such practices have ambiguous effects on economies. The article discloses main issues of the integration of financial markets in the framework of the Eurasian Economic Union through the analysis of preconditions and conditions of the formation of a single financial market. The research examined development of financial trade between Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia, creation of supranational bodies on regulation of the financial markets, formation of the developed financial infrastructure and favorable investment climate. The research based empirical study of statistical and secondary data of the member states, and conclusion and propositions on policies have been derived from the comparative analysis of the economies of these countries.

Keywords: banking sector; currency; financial markets; financial integration; loan; stock market; the Eurasian Economic Union.

JEL Classification: G15; G21; O11.

Introduction

In modern conditions globalization processes in the world significantly affect foreign policy of various countries (Nazarbayev 2017). In this regard, countries with territorial proximity aim at uniting markets of goods, capital, and labor, in order to increase their competitiveness in the international markets. In particular, the Agreement on the Eurasian Economic Union (EEU) was signed by Belarus, Kazakhstan and Russia in May 2014. Later, Armenia and Kyrgyzstan joined the EEU. Strategic goal of the EEU suggests that economic integration will contribute to the growth of trade, expansion of markets, and attraction of foreign investment, modernization and competitiveness of these countries. Meanwhile, the emphasis will be on the integration of financial markets, which, of course, affects the effectiveness of macroeconomic policies of the member countries and provides them certain competitive advantages. In this process there are two vectors of the financial integration: formation of the single stock market and the capital market.

1. Challenges and Opportunities of Financial Markets' Integration

From our point of view, development of the financial integration within the framework of the newly formed EEU can have both positive and negative sides. Increased dependence of the financial systems of participating countries must be justified by an increase in the effectiveness of their social and economic development. What will the member states of the EEU gain, and what they may lose in the process of the integration of national financial markets? How can public authorities and financial market participants contribute to the creation of the single financial market? Answers to these questions can be found in case of studying causes and conditions of the financial integration, analyzing peculiarities of national financial markets of the member states and identifying prospects of their development in the context of a single economic space. The article is devoted to these aspects in the study of problems of formation of the single financial market of the EEU.

At the initial stage of the development of integration processes between Belarus, Kazakhstan and Russia, commitments were made to form a unified macroeconomic policy in three areas:

- The deficit of budget in the state governance sector in countries should not exceed 3% of the GDP;
- The public debt should not exceed 50% of the GDP;
- The inflation rate cannot exceed the one in the member state, in which the figure is lowest, for more than 5%.

Similar macroeconomic indicators were recorded in the Maastricht Treaty of 1999, which is the legal basis for the European Monetary Union. The requirement on public debt in the Eurasian Union even tougher than in the European Union: in the EU it may be 60% of GDP, while in the EEU – in the range up to 50%.

Achievement of the defined criteria is needed to ensure the macroeconomic stability, sustained economic growth and development of the credit and financial system of the EEU. In this regard, in 2013, public provision of credit and financial system were aimed at improving performance and reducing risks to banking business, based on the standards of the Basel Committee on Banking Supervision. In 2012, monitoring of the macroeconomic indicators showed that all Member States adhered to the EEU quantified values. However, in Belarus, the inflation level was above the value, as well as in Kazakhstan the national budget deficit, according to preliminary data, reached the limit of 3.0% of the GDP.

As for integration of financial markets, first steps in this direction have been made in connection with the ratification of the 'Agreement on the creation of conditions in the financial markets in order to ensure the free movement of capital' from 01.01.2012. In the framework of the Agreement measures have been prescribed to harmonize legislation on the intra-national financial services and conduct banking activities, as well as an exchange of information on the management and development of the financial market between Belarus, Kazakhstan and Russia.

Basic agreements of the EEU disclose the need to create conditions for mutual recognition of licenses and other permits for all participants in the financial markets by 2020. Under financial markets, we understand business of banking, insurance sector and securities market. Today, in the EEU countries banking sector, securities market and insurance sector are carried out in accordance with national legislation, which do not fully take into account the integration purposes. Therefore, there should be determined guidelines for the development of integration processes in the future and agreement on long-term policy of the countries in the area of financial markets.

At this stage of development of the financial integration in the EEU member countries, there are two main objectives: increasing transparency of the financial market and creation of an integrated information space. In this regard, the Eurasian Economic Commission produced two agreements: the agreement on the requirements for the implementation of activities in financial markets and the agreement on the exchange of information. Establishment of the legal framework in accordance with the International Financial Reporting Standards will achieve comparability concerning the disclosure requirements of companies. It will increase investors' confidence and maintain transparency of the financial markets.

Agreement on the implementation of activities in the financial markets of the EEU assumes harmonization of the various aspects of the financial regulation until 2022 and is aimed at creating a single financial market. Realization of this goal will be implemented in three phases. Each of them represents a new level of integration of relations. At the first stage,

before the end of 2017, it is planned to create a single conceptual framework, organizational and legal forms of the single financial market participants and the harmonization of legislation to protect the rights of consumers of financial services. In the second phase, policy of harmonization of legislation in the field of licensing and regulation of participants in the single financial market will be held up to 2020. In the third stage, supervision and control of the financial market of the EEU will be ordered until 2023.

Stock markets in the countries of the EEU are relatively new and have uneven development. For example, in some countries there can be a high capitalization of this segment, while in other countries - low liquidity, and in the third - too narrow range of financial instruments. Therefore, for the EEU in the initial stage of integration, it is necessary to determine mechanisms of regulation of relations on the basis of the volume of non-equivalence of the financial markets evaluate and compare state of the stock markets of Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia.

As can be seen from Table 1, Russia carries out the stock exchange transactions in larger quantities than other countries. However, in 2016 compared with 2012, Belarus and Russia had a negative trend in the rate of growth of this indicator, which amounted to 94.8% and 45.9 % accordingly. On the contrary, Armenia, Kazakhstan and Kyrgyzstan have positive growth rates in the stock market (950.0 %, 142.0% and 572.0% respectively).

Table 1. Volume of the stock markets of participating countries of the EEU (in million USD)

	2012	2013	2014	2015	2016	2016 to 2012, %
Armenia	12	41	152	29	114	950
Belarus	5,081	5,554	6,470	6,152	4,815	94.8
Kazakhstan	88,270	89,345	61,560	116,235	125,369	142
Kyrgyzstan	25	34	30	62	143	572
Russia	776,698	755,028	550,141	338,871	357,164	45.9

Source: Compiled and calculated by authors according to financial organizations in the Eurasian Economic Union from 2012 till 2016.

During the period from 2012 to 2016, the largest share in the total volume was accounted for Russia, whose share was 89.27% in 2012 to 73.25% in 2016. At the same time in Kazakhstan, this figure ranged from 11.36% to 35.10%, in Belarus – from 0.65% to 1.35% for the respective period, while in Armenia and Kyrgyzstan the indicator did not reach 1.0%. This fact can be considered as a potential problem in the functioning of the integrated financial market, where Russia may find itself in a monopoly position with respect to the other participants (Table 2).

Table 2. Structure of the stock market of the EEU (in %)

Country	Years				
	2012	2013	2014	2015	2016
Russia	89.27	88.83	88.97	73.45	73.25
Kazakhstan	11.36	11.83	11.19	34.30	35.10
Belarus	0.65	0.74	1.18	1.82	1.35

Source: compiled and calculated by authors according to financial organizations in the Eurasian Economic Union from 2012 till 2016.

Another problem with the stock market can be a major part of institutional members, which is very different on the quantitative composition. Suffice it to note financial market participants, such as banks and insurance companies. According to statistics, Russia dominates the quantitative composition of these institutions in multiple degrees. Thus, in 2016 the number of banks in Armenia was 19, in Belarus – 24, in Kazakhstan – 33, in Kyrgyzstan – 25 and in Russia – 623. Situation for the number of insurance companies for the same period was as follows: in Armenia the number of companies was 7, in Belarus – 23, in Kazakhstan – 32, in Kyrgyzstan – 19 and in Russia – 256.

In regard to the integration of the Kazakhstan Stock Exchange (the KASE), nowadays it is not ready for radical changes due to low liquidity, deficit of the financial instruments and low investment attractiveness. It is necessary to bring the harmonization of legislation in the field of licensing, regulation and supervision of financial markets and financial institutions, and to protect the interests of its members. A very important issue in the unification is related to the conditions of competition that are significantly different. They include size of the economies, banking sector, methods of funding, and

other components. The solution to these problems requires a long period of time, so this process involves stages of development until 2025.

In this way, it should be noted that results of the analysis indicate the uneven development of national stock markets of the EEU, which may adversely affect financial integration. However, despite the unevenness of the development, they can achieve the greatest efficiency by combining into the single stock exchange under the EEU. In this regard, it is necessary for the unification of existing legislation to correspond with the requirements of the EEU, solve issues in the development and implementation of new mechanisms to regulate their activities, and create a well-developed infrastructure.

Analysis of the current state of national credit markets of the EEU showed the following results. If we compare the volume of assets and liabilities, banks in Kazakhstan have a greater amount of assets and liabilities, than similar institutions in other countries, except for Russia (Table 3).

Table 3. The average amount of assets and liabilities of banks (\$ bn.)

Country	2012		2013		2014		2015		2016		2016/2015, %	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Armenia	6.1	5.1	7.3	6.1	7.2	6.2	7.1	6.1	8.3	6.9	116	113
Belarus	37.1	31.8	41.3	35.5	41.8	36.3	35.0	30.7	33.8	29.4	97	96
Kazakhstan	92.1	78.8	100.7	87.1	100.0	87.0	70.1	62.7	76.7	68.2	109	109
Kyrgyzstan	1.8	1.5	2.3	1.9	2.3	2.0	2.3	2.0	2.6	2.2	110	108
Russia	1630.1	1428.8	1754.5	1538.7	1380.3	1239.4	1138.8	960.5	1313.9	1165.2	116	121

Source: compiled and calculated by authors according to financial organizations in the Eurasian Economic Union from 2012 till 2016.

However, current situation in the banking sector of Kazakhstan is far from this ideal picture. Among 33 banks there are large, so-called systemically important banks, which have most of the assets, but now their financial situation has deteriorated. It should be noted that concentration in the banking sector of Kazakhstan remains high for many years. From 33 banks in Kazakhstan only 5 banks are accounted for more than 55 % of total assets, loans and deposits of the banking sector, which is confirmed by the data of the (Table 4).

Table 4. Concentration of the banking sector of Kazakhstan (in %)

Rates / Data	1.01.2012	1.01.2016
Share of 5 top banks in total assets of the banking sector of Kazakhstan.	65.2	55.7
Share of 5 top banks in total loan portfolio of the banking sector of Kazakhstan	86.0	61.5
Share of 5 top banks in total client deposits of the banking sector	65.2	58.5

Source: compiled and calculated by authors according to financial organizations in the Eurasian Economic Union from 2012 till 2016.

It means that in Kazakhstan banks-leaders are clearly distinguished and their competitiveness can overshadow the rest. In such case, smaller banks cannot compete in the integrated financial market. Preventing the development of such a scenario, the Kazakh regulatory institutions orient banks in the country on realization of measures on the enlargement of equity, assets and liabilities. At present, Kazakh banks move to conditions of functioning according to Basel-III.

Analysis of the monetary market of member countries of the EEU showed that for the period 2012 – 2016 it was developing unstably. So, in 2016 comparing with 2015, we can observe a sharp decrease in the activity of this market in Armenia, Belarus and Kazakhstan. In our country such situation is explained by devaluation of the national currency. In contrast, in Kyrgyzstan volume of trade in the money market increased more than 2 times. In regard to Russia, for the period 2013 – 2016, volume of trade in this market declined for 11.3% (Table 5).

Table 5. Volume of the monetary market of participating countries of the EEU (in million USD)

	2012	2013	2014	2015	2016
Armenia	15,909	16,998	16,368	2,085	16
Belarus	29,949	34,535	30,020	16,598	9,217
Kazakhstan	96,063	120,640	188,460	298,574	105,578
Kyrgyzstan	1,347	1,480	2,839	2,304	1,296
Russia	9,515,706	11,839,252	11,402,497	9,081,853	10,630,262

Source: compiled and calculated by authors according to financial organizations in the Eurasian Economic Union from 2012 till 2016

However, considering the proportion of countries in the money market, we can see that for the analyzed period the share of Russia is amounted to 99%. This is the evidence of underdevelopment of this market of other countries of the EEU. Consequently, it is necessary to implement sound policy of creation of the unified financial market to not violate principles of the competitiveness (Table 6).

Table 6. Structure of the monetary market of the EEU (%)

	2012	2013	2014	2015	2016
Armenia	0.17	0.14	0.14	0.02	0.00
Belarus	0.31	0.29	0.26	0.18	0.09
Kazakhstan	0.99	1.00	1.62	3.18	0.98
Kyrgyzstan	0.01	0.01	0.02	0.02	0.01
Russia	98.52	98.55	97.96	96.60	98.92
Total	100.0	100.0	100.0	100.0	100.0

Source: compiled and calculated by authors according to financial organizations in the Eurasian Economic Union from 2012 till 2016

Significant variation of the absolute indicators of Russia from other countries may be cited as justification for the undeniable fact of the exceeding absolute scale of Russian economy, its territory, population and the number of economic entities. This means that there are more resources among Russian banks and more possibilities of their movement to partner countries on favorable terms. For Kazakhstan, it would mean the inflow of foreign loans and increased number of Russian banks on the territory of the country.

Thus, current situation in the main sectors of the financial market formed a certain advantage for Russia, which could lead to financial flows in order to reallocate available funds on the markets of Kazakhstan and Belarus. Such movement, in our opinion, is a natural consequence of financial integration and the basis for the development of the regional financial market. The success of the results of the integration process can be assumed on the basis of what kind of arrangements will be reached in future. In this area balanced and proven international experience's approaches are needed. A very important step is to develop a system of legal and economic instruments, including institutional and operational mechanisms of a supranational level.

Conclusion

Harmonization of laws of the EEU member countries in the sphere of regulation of the financial market opens up new opportunities for financial and credit institutions to expand and penetrate international markets. From our point of view, benefits of the integration of financial markets in regional context should be remembered, such as consolidation of electronic trading systems in order to reduce cost, increase of liquidity of the stock exchange transactions, and user's access to all information for transactions, including quotes, research results and forecasts. Eventually, concentration of clearing and settlement service structures will facilitate creation of the financial infrastructure development of an integrated market.

For successful creation of the single financial market within the framework of the EEU, it is necessary to prepare certain conditions conducive to achieving this goal:

- (1) Development of a system of legal and economic instruments, including institutional and functional mechanisms on supranational level and, in particular, creation of a single supranational authority to regulate

the regional financial market for the purpose of designing and implementing a unified financial and monetary policy.

- (2) Formation of developed financial infrastructure, including international interbank settlement system with the appropriate infrastructure and technology.
- (3) Implementation of Basel 3 standards, as a basis for the effective cooperation of banking institutions in countries of the EEU, with a purpose of developing common standards for financial supervision, banking supervision and monetary regulation.

Current trends in the development of integration processes in the EEU, suggest positive results. Nevertheless, formation of a single financial market controversial and time-consuming process, so that its implementation should be carried out consistently and step by step without pressure factor of political will. Formation of the single financial market with high liquidity and stability to external influences, would contribute to achieving the objectives of economic development of the EEU participating countries, and would strengthen their position in the global competition.

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