

## **ANALYSIS OF INTEGRATION PROCESSES IN THE FINANCIAL SECTOR OF THE COUNTRIES OF THE EURASIAN ECONOMIC UNION**

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### **Abstract**

The Eurasian Economic Union (EAEU) is an international organization of regional economic integration aimed at improving the competitiveness of national economies, creating conditions for sustainable development and raising the living standards of member countries. One of the main characteristic features of integration are profound changes in the financial sphere - in the securities market, insurance, credit and foreign exchange market, as well as the formation of supranational financial institutions.

The purpose of this study is to analyze and assess the impact of the functioning of the EAEU on the development of financial institutions of member countries on the example of the Kyrgyz Republic. The research and information base was based on public reports of the National Statistical Committee, the Ministry of Economy and the National Bank of the Kyrgyz Republic, as well as on the results of scientific work related to the formation of a strategy for the development of financial markets. EAEU member states for the period up to 2025.

The scientific results consist in identifying promising areas for the development of relations within the EAEU aimed at optimizing financial systems, increasing the role of national currencies in mutual settlements, reducing the role of the US dollar in settlements and reserves, transferring the monetary and financial sector of the Union countries to internal sources of credit and linking monetary growth mass with growth of gross domestic product (GDP). Positive expectations of the EAEU member countries are associated with forecasts of a single financial services market by 2025, which should ensure effective protection of the interests of

consumers of financial services, mutual recognition of licenses in the banking system and in the insurance market, as well as in the services sector.

**Keywords:** Eurasian Economic Union, economic integration, financial institutions.

## **1. INTRODUCTION**

Kyrgyzstan has become a full member of the EAEU and its accession to the Union has become a nationwide event, as it now determines not only the development of the economy, but the strategic directions for the development of the entire country. For the further development of the EAEU, comprehensive coordination of monetary and fiscal policies in all countries participating in this integration education is necessary. Almost identical and moderate rates of inflation, mutual accessibility and price of financial resources, constant and steady economic growth, debt sustainability, balance of foreign trade, in the fiscal sphere - these are tasks that have yet to be accomplished within the Union.

## **2. IDENTIFICATION OF PROBLEMS OF DEVELOPMENT OF THE FINANCIAL SECTOR OF THE KYRGYZ REPUBLIC**

Entry into the EAEU was aimed at solving a number of problems. The internal factors that negatively influenced the structural changes in the republic include: economic instability, payment system crisis, weak product competitiveness, backwardness of the production and technological structure, low value added as a result of the export orientation of raw materials, lack of investment attractiveness, underdeveloped stock market, trade conflicts, unregulated pricing for energy and transit, lack of investment loans, weak expansion Single foreign trade infrastructure, inefficient foreign policy.

The Kyrgyz Republic planned to solve the listed problems, becoming a full member of the EAEU. As the main research method, a system analysis was used, which allows revealing and taking into account the structural links between the components of the financial markets of the EAEU member states in the process of their integration, liberalization, elimination of barriers to the free movement of capital, investments, and free trade in financial services within the Union. In particular, in the framework of this method, the historical, comparative legal, comparative methods and method of systematization will be applied. The implementation of each of the approaches is provided by the use of an integrated system of methods and tools, the use of current and retrospective data.

## **3. MAIN INDICATORS OF THE DEVELOPMENT OF THE FINANCIAL SERVICES MARKET OF THE KYRGYZ REPUBLIC WITHIN THE EAEU**

At present, the EAEU countries need to pursue a coherent policy at the macroeconomic level, which provides for the provision of general macroeconomic stability, the formation of common principles for the functioning of the economy, and bringing the core indicators to uniform requirements in order to increase sustainability and deepen the integration of participants' economies. Despite the fact that the country's accession to the EAEU had a difficult economic period, Kyrgyzstan from the first months of membership feels positive effects of integration. Since 2015, the gross domestic product of Kyrgyzstan has been growing at a rate exceeding the growth rate of GDP in the EAEU as a whole. According to ECE statistics, in 2017, GDP growth was 4.6% (according to IMF forecasts – 3,5%) (Figure 1) [1].

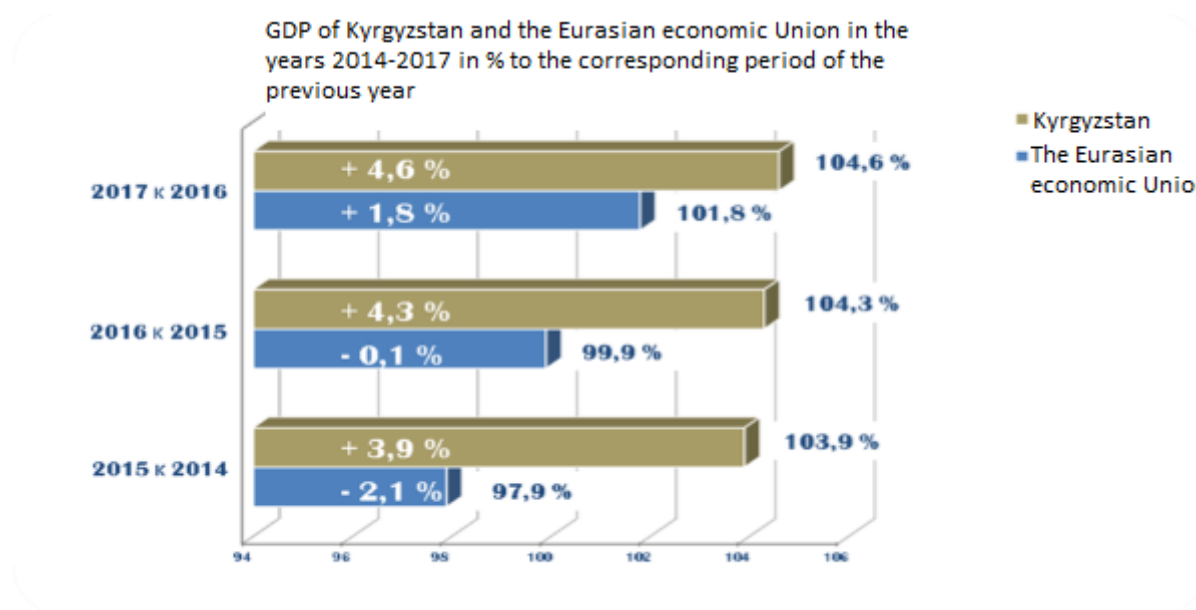


Figure1. Gross domestic product of Kyrgyzstan and the EEU countries, 2014-2017

In Table 1 presents a comparison of key macroeconomic indicators of the Kyrgyz Republic with established criteria. Significantly lower than other partners in the Union were indicators of Kyrgyzstan on revenues of the consolidated budget.

Among the disproportions can be noted the extremely low level of gross savings in the economy, which led to the need for significant external borrowing and the formation of substantial debt in excess of 50%.

**Table 1. Comparison of key macroeconomic indicators of the Kyrgyz Republic with established criteria [2,3,4].**

	Government debt / GDP	Inflation rate	Budget deficit
EAEU Treaty (criteria for entering the Union)	Not more than 50%	Should not exceed the lowest value among the EEU countries	no more than 3% of GDP
Kyrgyz Republic (2017)	62,7 %	3,7 %	3,3 %

The development of the integration process in the EAEU requires the creation of supranational financial institutions, which depends on the state of national banking systems, securities markets, insurance, and the foreign exchange market.

The national banking systems of the EAEU member States are characterized by both General trends and peculiarities. The General indicators include: the predominance of banks over non-Bank institutions; a sufficiently large level of interdependence and interconnectedness of sectors according to development trends; a high level of concentration of Bank assets (5 of the largest banks account for more than 50% of assets in Russia, KYRGYZSTAN, Belarus, Armenia); the level of capitalization of banks in relation to assets and the level of overdue loans is comparable in almost all countries except Kazakhstan; there is a low level of saturation of the economy with loans from banks and non-Bank financial and credit institutions (especially for Belarus, Kazakhstan and Kyrgyzstan). The main differences include: Russia's leadership in the size of assets of the banking sector and the degree of its development; significant features and differences in the level of development and the role of banking systems in the economy between other member States of the Union, the different level of banking regulation and supervision; significant differences in capital requirements, the degree of implementation of Basel II – III [5]. Of course, in General, the basic conditions

have been created for the operation of the nuclear power plant, in the form in which it now exists, the regulatory framework and the framework have been summed up and are constantly expanding. But this is not enough for the further and successful development of the Union. In our opinion, currently each member country integration of education there is a need to exert maximum effort in the development of basic industries of the national economy, banking sector, insurance system, stock exchange and currency markets, market direct foreign investment, improving balance of payments, government obligations, etc.

The results of the study of the financial institutions of the Kyrgyz Republic allow us to draw the following conclusions. In the Kyrgyz Republic at the end of 2017 compared to 2016, there was an increase in the main indicators of the banking sector: assets, loan portfolio and resource base. Risks in the banking sector at the end of 2017 were estimated as moderate. The banking sector has a high level of capital adequacy, which indicates the potential for further growth in the level of financial intermediation, efficiency and development of the banking system and sustainability in the future. As of the end of 2017, there were 25 commercial banks in the Kyrgyz Republic, including the Bishkek branch of the national Bank of Pakistan. Among the existing commercial banks, 18 banks had foreign capital. The share of foreign capital at the end of 2017 accounted for 49,8% of the banks capital (in 2016 – 44 %).

As a result of measures taken by the National Bank and the government of the Kyrgyz Republic, the level of dollarization of the banking sector in 2017 continued its decline, reaching a historic low of 38 percent.

For the member States of the Union is characterized by approximately the same level of capitalization of banks relative to their assets – an average of 12-13%, there has been a tendency to reduce the level of capital to the assets of banks for all member States of the Union, and in the regulatory requirements for the capital of banks, as well as in the size of banks in absolute terms characterized by significant differences. For example, the maximum requirements for equity capital of RUB 30 billion, which were established and entered into force in 2016, should be met by 2019. Optimization of these requirements can lead to the possibility of their implementation only by individual banks of Kazakhstan and Russia (in Armenia, Belarus and Kyrgyzstan there are no such banks).

In the Kyrgyz Republic, the weighted average rate on newly issued loans in the national currency in 2017 amounted to 19,8 % (decrease for the year by 4,7 %); in foreign currency – 10,5% (decrease by 2%) [6]. It should be noted that the existing interest rates on all types of loans in Kyrgyzstan remain quite high (at the end of 2016, the weighted average interest rates on loans for individuals on long – term loans amounted to 28,1%, for legal entities-21,1%). Therefore, in Kyrgyzstan, the problem of increasing the availability of credit resources for the population and business is extremely important.

It is worth noting the role of cross-border remittances of individuals for the economy of Kyrgyzstan. The volume of such transfers is close to 30% of the country's GDP and in nominal terms exceeds budget revenues. For example, cross-border transfers of individuals in 2016 amounted to 29,4% of the country's GDP, as well as exceeded the country's budget revenues (102,3% of the consolidated budget) [7].

The existing preferences also contributed to the fact that citizens of the Kyrgyz Republic are currently employed in higher paid and prestigious jobs compared to the period before joining the EAEU.

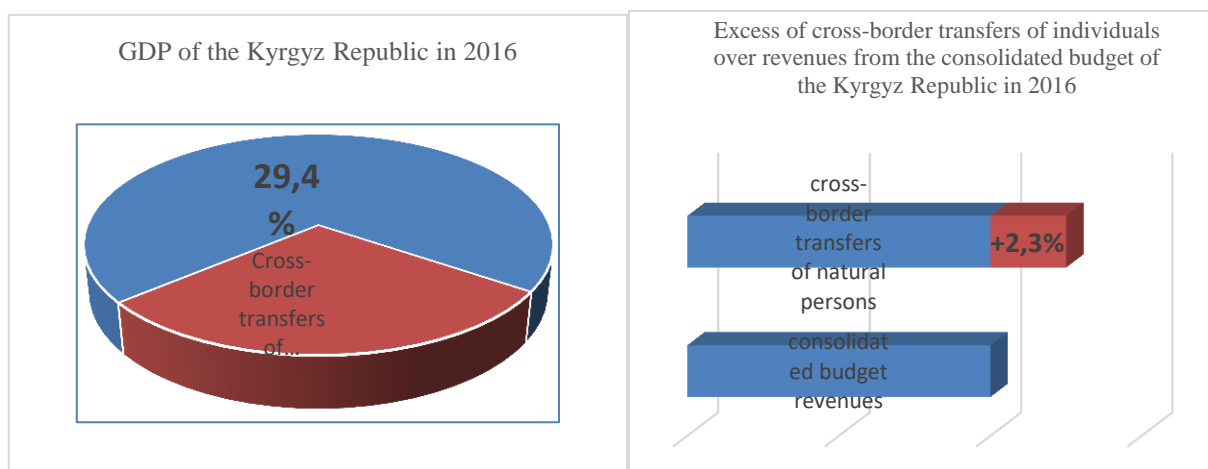


Figure 2. Cross-border transfers of individuals in the economy of the Kyrgyz Republic

The situation in the domestic currency market of the Kyrgyz Republic was relatively stable, which minimized the participation of the National Bank. The growth of spot operations was mainly due to an increase in the volume of operations in Russian rubles (+60,1 %), us dollars (+31,1 %), Euro (+6,1 %), Kazakh tenge decreased by 2,6% for the year. There are no significant changes in the share of currencies. Thus, for a number of years, the predominant share in the calculations is the ruble and the us dollar, and the share of the ruble has been growing since 2011 both in the total amount and in the number of transactions.

The stock markets of the EAEU countries are characterized by a heterogeneous structure of banking and non-banking participants. Kyrgyzstan is characterized by a marked decline in trading activity since 2009, the subsequent revolution and change of power in 2010, the consequences of the global economic crisis, which affected the economy of the most important trading partners of Kyrgyzstan, did not contribute to the recovery of the stock market.

Currently, the stock market of the Kyrgyz Republic is represented by both state and corporate securities. The market of government securities issued by the government of the Kyrgyz Republic and the National Bank in 2017 was represented by the following types of securities: – state Treasury bills (GKV); – state Treasury bonds (GKO); – notes of the national Bank of the Kyrgyz REPUBLIC; – Treasury obligations (CO); – bills of exchange. The total volume of government securities in circulation at the end of 2017 increased by 31,9 % to 35,5 billion soms due to the growth of GKO (+59,1 %).

In 2017, the total volume of trading in securities on the stock market amounted to 7,9 billion soms, down by 56,7 %. The number of transactions with securities for the year decreased by 19,6% to 3,137 transactions compared to 2016. The main share of trades was in the primary market, where the figure was 44,9 %, and the volume of transactions – 3,5 billion soms. The share of the OTC market and the secondary market amounted to 40,9 percent (3,2 billion soms) and 14,2 percent (1,1 billion soms), respectively. In 2017, 59 issues of securities totaling 5,5 billion soms were registered, of which 11 issues of securities were constituent (in the amount of 487 million soms) and 48 issues – additional (in the amount of 5 billion soms). Of the total issue of shares amounted to 4,7 billion soms, bonds - 540 million soms and housing certificates - 200 million soms. Another negative trend is the gradual reduction in the number of listed companies. For example, 29 issuers were listed on the Kyrgyz stock exchange in 2017, which is only three issuers more than in 2016.

The volume of portfolio investments in the EAEU member States generally reflects the level of development of the country's financial market – higher volumes are typical for Russia and Kazakhstan (about 1-2% of GDP), including a large share of portfolio investments in relation to direct investments (respectively 71% and 100% in 2014), insignificant volumes (almost no portfolio investments) – for Armenia, Belarus and Kyrgyzstan, which have more underdeveloped securities markets.

The level of development of the insurance market of the EAEU member States is characterized by heterogeneity and significantly differentiated. The lowest level of development of the insurance market is characterized by Armenia and Kyrgyzstan, the highest – Russia. The volume of insurance premiums formed and insurance payments made (relative to GDP) is maximum in the Russian Federation. In Armenia and Belarus, higher rates of development of the insurance industry than in Kazakhstan and Kyrgyzstan have become possible due to the wider use of compulsory types of insurance (for example, the introduction of CTP in Armenia). In Kyrgyzstan, the introduction of CTP is fixed at the legislative level, in reality, participants ignore insurance relations. The Russian insurance market is the leader in the EAEU in terms of absolute indicators of formed insurance premiums, payments and reserves. Coverage of compulsory insurance varies in these countries. According to this criterion, there are 3 categories: high level (Russia); medium (Belarus, Kazakhstan); low (Armenia, Kyrgyzstan). The total number of participants in the insurance market of the countries is comparable to the volume of the market. For example, in 2015 there were about 400 insurance companies in Russia, 34 in Kazakhstan, 24 in Belarus, 17 in Kyrgyzstan, and 7 in Armenia.

In the Kyrgyz Republic, there are financial institutions that support business development in financing investment projects, and play an important role in adapting the Kyrgyz economy to operate in the EAEU.

Investment projects of Russia in the Kyrgyz Republic are implemented mainly in the field of financial intermediation and insurance, as well as in the energy sector. Such institutions include, first of all, the Russian-Kyrgyz development Fund, the Eurasian development Bank (EDB), the Eurasian Fund for stabilization and development, etc.

The Russian-Kyrgyz development Fund was established in accordance with the agreement Between the Government of the Russian Federation and the government of the Kyrgyz Republic dated November 24, 2014. Currently, the authorized capital of the Fund is formed in the amount of \$ 500 million USA. In 2015-2016, the Fund financed 767 projects worth \$ 248 million. US, of which 31 projects is a large business, and

736 projects of small and medium-sized businesses. The Fund offers two main products: direct financing and SME financing through commercial banks.

Funds are allocated for the acquisition, renovation, modernization and expansion of fixed assets. Priority attention is paid to the development of agriculture, clothing and textile industry, mining and metallurgical industry, transport, housing, infrastructure development.

For large companies, loans of \$ 1 million or more are envisaged. US \$ 4% to 7% per annum for a period of 5 to 15 years depending on the industry. In this case, the company's own contribution should be at least 15% of the project amount, collateral - not less than 120% of the collateral value. Examples include the reconstruction of the Manas and Issyk-Kul international airports in the amount of \$ 12,4 million. Us \$ 15,5 million, rehabilitation and modernization of two sugar refineries in the amount of us \$ 15,5 million. Construction of a factory for the production of knitted fabrics in Tokmak in the amount of \$ 7,5 million USA.

The continuation of the full-scale work of the Russian-Kyrgyz development Fund will contribute to the revival of the main sectors of the Kyrgyz economy.

There is a great potential for Kyrgyzstan in cooperation with the Eurasian development Bank (EDB) to implement socially significant investment projects in key sectors of the national economy. The first project implemented in Kyrgyzstan for EDB provided financing for the purchase of fuel for Bishkek CHPP (a credit line in the amount of \$ 30 million was opened). The only major power plant in the Northern part of the country, which produces electricity to alleviate its deficit in winter and dry years, has been fuelled for a period of 2,5 years. At the same time, projects in such sectors of the Kyrgyz economy as industry, agriculture, as well as small and medium-sized businesses were financed.

Cooperation with the Eurasian Fund for stabilization and development provides obvious economic dividends. The Eurasian Fund for stabilization and development (FSR, Fund; formerly The EurAsEC anti — Crisis Fund) is a regional financial mechanism with a volume of \$ 8,513 billion. USA, which was established in 2009 by Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan. The Fund was established in order to overcome the negative crisis consequences, ensure long-term sustainability and promote the integration of the economies of the member States of the Fund. The Fund has already approved and is implementing projects in the field of hydropower and transport infrastructure : - rehabilitation of Toktogul HPP (phase 2) for \$ 100 million. Reconstruction of the Bishkek – Osh road section, phase IV for \$ 60 million. Financing of the supply of agricultural machinery to the Kyrgyz Republic for \$ 20 million. Commissioning of the second hydroelectric unit of the Kambarata HPP-2 for \$ 110 million. USA. In the future-the implementation of the third phase of the project for the reconstruction of Toktogul HPP.

Investments of the Republic of Belarus in the Kyrgyz Republic are presented mainly in the form of loans allocated in accordance with the agreement Between the Government of the Republic of Belarus and open joint stock company "AYL Bank" dated may 27, 2016 on the terms of loans for the purchase of goods produced in the Republic of Belarus in the Kyrgyz Republic.

Currently, economic growth in the Kyrgyz Republic is provided by all sectors of the economy, and the growth rate in the sectors above the average for the EAEU. This was facilitated by several reasons: new opportunities for Kyrgyz business to work freely in the integration space; restoration of economic growth in the EAEU countries, which are our main trading partners. The share of trade with these countries in the total volume of trade of Kyrgyzstan in 2017 amounted to 38,6% (in 2016 – 37,2%). Kazakhstan (52,3% in exports, 31,7% in imports) and Russia (46,2% in exports, 63,8% in imports) occupied the largest share in Kyrgyzstan's trade with the EAEU countries [8].

The growth of trade and the improvement of its structure over the past two years shows that Kyrgyzstan is getting impressive results from its accession. In integration education. Simultaneously with the increasing trade turnover, revenues to the country's budget from foreign economic activity, in particular from import customs duties, VAT and excise duties are growing.

#### **4. CONCLUSION**

The study showed that the creation of a single financial market of the EAEU is a necessary condition for the integration of the economies of the Union, opening up opportunities for its progressive development, which consists in:

- Linking currency, credit and stock markets;
- Ensuring the convertibility and stability of national currencies;

- Expansion of financial market instruments;
- Solving the problem of long-term credit resources deficit;
- Improvement of information exchange on currency and credit market statistics, securities market, trading methods, etc.;
- Elimination of difficulties associated with the merger of trading platforms;
- Improving the financial literacy of the population of the integration space.

To improve the efficiency of the integration process, the most important is the optimization of financial systems; increasing the role of national currencies in mutual settlements on the basis of their convertibility; the creation of a conventional unit for international settlements within the EAEU; ensuring the competitiveness of products, in particular for trade operations within the EAEU before replacing it with a single currency; reducing the role of the us dollar in calculations and reserves; the transfer of the monetary sector of the Union countries to domestic sources of credit; linking the growth of the money supply to GDP, etc.

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