

**REGIONAL ECONOMIES**

**THE IMPACT OF THE CUSTOMS UNION AND  
THE EAEU ON THE SMALL AND  
MEDIUM BUSINESS IN KAZAKHSTAN**

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## A B S T R A C T

**T**he Customs Union (CU) and the Eurasian Economic Union (EAEU) are an effective mechanism for protecting the domestic market, because the member states of these organizations follow a coordinated foreign trade policy. Conditions are being created for the development of the non-primary sector in these countries so as to modernize, diversify and enhance the competitiveness of their economies. For the countries of the EAEU, whose members are Russia, Belarus, Kazakhstan, Kyrgyzstan and Armenia, the development of small and medium-sized enterprises (SMEs) is highly relevant, especially considering the recession and Western economic sanctions against Russia, the largest EAEU economy.

At the same time, their development encounters significant difficulties. This article examines the current situation and development trends in Kazakhstan's small and medium business since the establishment of the Customs Union of Russia, Belarus and Kazakhstan in 2010 and the Eurasian Economic Union on 1 January, 2015. It shows the areas of government support for SMEs and argues the need for the development of a common strategy to regulate small and medium business in the EAEU space. In the functioning of the Kazakhstan economy as part of the Customs Union and the EAEU, the authors have identified problems caused by inadequate interaction between business and government.

**KEYWORDS:** *Kazakhstan, Eurasian Economic Union (EAEU), small and medium business, Customs Union, SMEs.*

## *Introduction*

The problem of enhancing the competitiveness of small and medium business is currently on the agenda of the Republic of Kazakhstan as a major factor of its integration into the common economic space. It is important to carry out full-scale legislative and administrative reform in the country in order to support small and medium-sized enterprises (SMEs) and create a favorable investment climate.

At the interstate level, it is necessary to resolve issues in harmonizing national legislation and creating a level playing field for market actors. Among other things, it is necessary to optimize product certification procedures and amend Russian tax laws so as to abolish VAT on rail transportation.

At the national level, it is important to create a state agency to regulate SME activities, charged with the tasks of protecting the interests of entrepreneurs, strengthening relations between business and government, and helping SMEs to adapt to the new economic conditions.

The development of small and medium business is the foundation of any economy. Without a developed SME sector, it is difficult to talk about a stable economic situation in the country. That is why small and medium business came to be regarded as a key sector of the economy in Kazakhstan back in the early days of independence. In 2014, according to EU data, SMEs constituted 99.8% of all enterprises in the non-financial business sector of the EU-28, totaling 22.3 million enterprises. The EU has an average of 5 SMEs per sq km. In 2014, its SMEs employed almost 90 million persons (67% of all employees) and accounted for 58% of value added in the non-financial business sector.<sup>1</sup>

<sup>1</sup> See: [<http://www.zakon.kz/4695650-vklad-msb-v-vvp-kazakhstana-za-2014-god.html>], 10 December, 2016.

In our opinion, the activity of SMEs in the European Union is one of the crucial factors driving integration in the EU-28.

Kazakhstan draws on the successful experience of developed countries, since the improvement of mechanisms for government support of small and medium business is a constant focus of attention for the country's leadership. In the developed countries, for example, large businesses are not contrasted with small and medium businesses. On the contrary, these countries foster the principle of cooperation between large, small and medium-sized enterprises, so that large associations do not inhibit the development of small or medium businesses: they complement each other, especially in areas such as innovation and specialization of production.

Small and medium business is a type of economic activity designed to make profit and produce a social effect through organization, development, production and sale of goods. Its essence is manifested in proactive, innovative and independent activity. The purpose of small and medium businesses is to earn profit and personal income from foresight and careful planning, on the one hand, and to make the most efficient use of the factors of production and unlock human creative potential, on the other.

The essence of small and medium business is revealed in greater depth through its main functions: innovation, resource, organization and motivation.<sup>2</sup>

As a phenomenon of economic life, small and medium business always develops in a specific socioeconomic and historical environment. That is why its continuous reproduction requires certain prerequisites.

## Materials and Methods

For an analysis of the state and development of economic integration in the EAEU, it is important to analyze the state, dynamics and areas of activity of SMEs. The purpose of this investigation is to study Kazakhstan's SME sector, its dynamics since the 2000s, and the current state of this component of the national economy under regional economic integration as it enters a new stage of development.

In our study, we have used a comprehensive approach to analyze the export potential of SMEs based on national and regional information sources, monitoring of printed and electronic business and specialized publications, analytical reviews, and the materials of marketing and consulting firms for the period from 2005 to 2015. The key macroeconomic indicators for the EAEU countries were taken from UNCTAD sources in order to ensure their comparability in dollar terms.

The major limitations of the study were the lack in official statistics of a more or less realistic assessment of the export activities of SMEs in all CU/EAEU member countries, including Kazakhstan, and the differences in the legislation of the EAEU countries regarding SMEs. For example, the concept of "small or medium-sized enterprise" is still lacking in the Customs Code of the Russian Federation.

The foundations of the theory of development and the economic role of enterprise, including small-scale enterprise, were laid by Joseph Schumpeter. An analysis of the economic literature shows

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<sup>2</sup> See: I.N. Chuev, T.M. Panchenko, V.S. Novikov, O.A. Konnova, N.G. Iraeva, I.S. Karabulatova, "Innovation and Integrated Structures of the Innovations in Modern Russia," *International Review of Management and Marketing*, Vol. 6, No. 1S, 2016, pp. 239-244; N.R. Saenko, A.A. Sozinova, I.S. Karabulatova, I.V. Akhmetov, O.V. Mamatelashvili, E.E. Pismennaya, "Research in Action Integrated Marketing Communications as the Elements of Information and Virtualization Market Relations," *International Review of Management and Marketing*, Vol. 6, No. 1S, 2016, pp. 267-272; O.A. Koryakovtseva, I.I. Doronina, T.M. Panchenko, I.S. Karabulatova, Z.M. Abdullina, "Research of Category «Motivation» as a Basic Tool of Personnel Management," *International Review of Management and Marketing*, Vol. 6, No. 1S, 2016, pp. 293-299.

that, from the perspective of the macro system (the state), researchers identify the following functions of SMEs:

- (a) competition (F. Hayek);
- (b) innovation (J. Schumpeter,<sup>3</sup> P.F. Drucker,<sup>4</sup> P. Koveos<sup>5</sup>);
- (c) job creation (D.L. Birch<sup>6</sup>); and
- (d) creation of the conditions for the emergence of the middle class (A. Aganbegyan and others<sup>7</sup>).

The latter is particularly important for emerging market countries (with a transition economy).

The object of investigation was the small and medium business sector in Kazakhstan, whose development over the last decade was analyzed in this study.

## Results

In the process of implementation of the Concept of Transition of the Republic of Kazakhstan to Sustainable Development, the efficiency and stability of small enterprises, the establishment of new economic ties (including foreign economic ones) with their participation, and the intensification of their production and innovation activities are of particular importance.

According to the Law of the Republic of Kazakhstan on Private Enterprise (No. 124-III of 31 January, 2006), small businesses (enterprises) are individual entrepreneurs operating without the formation of a legal entity with an average annual number of employees not exceeding 50 persons, and legal entities engaged in private business with an average annual number of employees not exceeding 50 persons and an average annual value of assets not exceeding 60,000 times the monthly calculation index (MCI) set by the law on the republican budget for the corresponding fiscal year.<sup>8</sup>

Medium businesses (enterprises) are individual entrepreneurs operating without the formation of a legal entity with an average annual number of employees exceeding 50 persons, and legal entities engaged in private business with an average annual number of employees exceeding 50 but not exceeding 250 persons and an average annual value of assets not exceeding 325,000 times the monthly calculation index set by the law on the republican budget for the corresponding fiscal year (Para 7 of Art 6 of the Law).<sup>9</sup>

This definition exists in Kazakhstan's legislation since 2006, while small business enterprises began to appear back in the early 1990s, mainly by spinning off from state-owned parent enterprises. In 1991, these were mainly limited liability partnerships (LLPs). During the first half of 1991, many of them were reorganized into small businesses based on private equity ownership.<sup>10</sup>

<sup>3</sup> See: J. Schumpeter, *The Theory of Economic Development. Capitalism, Socialism and Democracy*, Harper & Row, New York, 1975.

<sup>4</sup> See: P.F. Drucker, *Innovation and Entrepreneurship: Practice and Principles*, Pan Books, London, 1986.

<sup>5</sup> See: P. Koveos, "Venture Entrepreneurship, Innovation Entrepreneurship, and Economic Growth," *Journal of Developmental Entrepreneurship*, Vol. 9, No. 2, 2004.

<sup>6</sup> See: D.L. Birch, *Job Creation America. How Our Smallest Companies Put the Most People to Work*, Free Press, New York, 1987.

<sup>7</sup> L.V. Shkvarya, "Tekhnologicheskie platformy kak predposylka ustoichivogo razvitiya stran SNG v postkrisisniy period," *Gorny informatsionno-analiticheskiy biulleten (nauchno-tehnicheskii zhurnal)*, No. 4, 2011, pp. 374-378.

<sup>8</sup> See: Law of the Republic of Kazakhstan No. 124-III of 31 January, 2006, "On Private Enterprise," available at [<http://www.pavlodar.com/zakon/?dok=03264>], 10 December, 2016.

<sup>9</sup> See: *Ibidem*.

<sup>10</sup> See: A.K. Oteshova, *Razvitie malogo biznesa v Respublike Kazakhstan*, Chelyabinsk, 2013, pp. 110-113.

According to statistics, as of 1 January, 1992, there were 6,445 small enterprises of all kinds in Kazakhstan (including 1,350 building organizations, 954 industrial enterprises, and 648 trade and catering enterprises). By 1 January, 1993, their number reached 12,690 (including 3,092 trade and catering enterprises, 1,978 building organizations, and 1,703 industrial enterprises).<sup>11</sup>

Thus, one can say that the quantitative and qualitative recovery of this segment of Kazakhstan's national economy began precisely in that period with the support of the national government (programs in support of national entrepreneurs are being implemented since 1992), which particularly intensified in the 2000s.

As of 1 January, 2015, according to national statistics, as many as 1,655,980 SMEs were already registered in Kazakhstan (see Table 1).<sup>12</sup>

Table 1

Performance Indicators for Kazakhstan SMEs (2005-2014)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Registered SMEs, thousands	743	840	938	1026	935	1,197	1,384	1,400	1,536	1,656
SME employees, thousands	1,876	1,952	2,121	2,153	2,297	2,631	2,427	2,555	2,636	2,810
Production of goods and services, millions of tenge	1,544	1,930	2,525	4,873	5,367	7,276	7,604	8,012	9,020	15,568
Estimated SME contribution to Kazakhstan's GDP, %	10.5	9.8	10.7	16.7	17.7	20.6	17.5	17.3	16.9	26.2

*Source:* Compiled using data from statistical yearbooks of the Republic of Kazakhstan for 2006-2015.

As our analysis shows, in 2014 the number of registered SMEs increased by 7.8% (by 120 thousand in absolute terms), while the share of active SMEs increased by 5.5% to 1,324 thousand. In 2010-2014, the share of active SMEs in Kazakhstan varied within the limits of 55% to 61%.<sup>13</sup>

An analysis of data presented in Table 1 shows that in 2014 the number of people employed in the SME sector increased by 174 thousand to more than 2.8 million on 1 January, 2015; at the same time, the SME sector accounts for only 30% of Kazakhstan's total working population.

In 2014, the production of goods and services by SMEs increased to 15.6 million tenge, or 1.7 times from 2013 and 2.1 times from 2010 (the year of establishment of the Customs Union of Russia, Kazakhstan and Belarus). In addition, the contribution of the SME sector to the country's GDP has increased significantly (to 26.2% in 2014). Considering the insignificant increase in quantitative indicators (the total number of SMEs and their employees), such rapid growth makes it possible to speak about qualitative changes in the SME sector, particularly improved labor productivity and efficiency. This, in turn, is primarily a result of the implementation of the national strategy for the development of business as an engine of growth in this new economic area. As President Nursul-

<sup>11</sup> See: *Kratki statisticheskiy iezhegodnik 1993*, State Committee on Statistics of the Republic of Kazakhstan, Almaty, 1993, p. 100.

<sup>12</sup> See: [<http://www.zakon.kz/4695650-vklad-msb-v-vvp-kazakhstan-za-2014-god.html>], 12 December, 2016.

<sup>13</sup> See: *Maloie i sredneye predprinimatelstvo v Respublike Kazakhstan 2010-2014*, Statistical Yearbook, Committee on Statistics of the RK Ministry of National Economy, Astana, 2015, p. 43.

tan Nazarbaev of Kazakhstan said in his 2014 Address to the Nation, “Kazakhstan’s Way 2050: Common Aim, Common Interests, Common Future,” the share of small and medium-sized businesses should double by 2030.<sup>14</sup>

On the other hand, our study shows that the quantitative and qualitative improvements in the performance of SMEs in Kazakhstan coincide with the formation and activity of the Customs Union and the EAEU (which has expanded the economic potential of the Customs Union) and are undoubtedly a consequence of their activities.

## Discussion

For the group of countries with transition economies, the activity of SMEs is of particular importance because of the need to address the tasks of structural, innovation and social change. They have been studied in a number of research works published in Central and Eastern Europe, Asia<sup>15</sup> and Latin America. Researchers note the growing role of SMEs in regional and global, as well as national, markets.<sup>16</sup> “Globalizations together with the reduction in trade barriers and tariff due to regional economic integration and World Trade Organization (WTO), together with the development in information and communication technology provide the opportunity for small and medium enterprises (SMEs) to expand their business into foreign market. Undoubtedly, SMEs play an increasingly active role in international markets in recent years and rapidly expanding their businesses to international markets, using international diversification as an important strategic option to achieve growth.”<sup>17</sup>

Thus, an important component of the role of SMEs in the national economy is that they promote the development of regional economic integration (the “micro level” of economic integration that forms through the creation of regional concerns, holding companies and joint ventures), on the one hand, and that they are an indicator of its state and dynamics, on the other. This means that sustainable development of SMEs, especially in the area of export-import operations, being a result of the creation of a free trade area (FTA) or a customs union (CU), may be evidence of the positive impact of integration processes in the region. For example, given objective resource and market constraints on development at the national level, SMEs can obtain additional resources and opportunities (particularly for the development of clusters) in the regional market as they are protected from third-country competition by a common customs tariff of the FTA and/or the CU. East European countries, among others, have had such experience, and this experience has proved to be very successful for the development of SMEs, in the opinion of D. Ionescu.<sup>18</sup>

<sup>14</sup> See: Address of the President of the Republic of Kazakhstan Nursultan Nazarbaev to the Nation, 17 January, 2014, available in Russian at [[http://www.akorda.kz/ru/addresses/addresses\\_of\\_president/page\\_215750\\_poslanie-prezidenta-respubliki-kazakhstan-n-nazarbaeva-narodu-kazakhstana-17-yanvarya-2014-g](http://www.akorda.kz/ru/addresses/addresses_of_president/page_215750_poslanie-prezidenta-respubliki-kazakhstan-n-nazarbaeva-narodu-kazakhstana-17-yanvarya-2014-g)], 10 December, 2016.

<sup>15</sup> See: Th.H. Nguyen, Q. Alam, D. Prajogo, “Developing Small and Medium Enterprises (SMEs) in a Transitional Economy—from Theory to Practice: An Operational Model for Vietnamese SMEs,” *Journal of Sustainable Development*, Vol. 1, No. 1, 2008.

<sup>16</sup> See: L. Shkvarya, O. Grigorenko, A. Strygin, V. Rusakovich, S. Shilina, “The Impact of the Global Economic Crisis on Asian Technology Markets (India and China),” *Central Asia and the Caucasus*, Vol. 17, Issue 2, 2016, pp. 103-113.

<sup>17</sup> See: M.I. Masum, A. Fernandez, *Internationalization Process of SMEs: Strategies and Methods. Master Thesis in International Business and Entrepreneurship, School of Sustainable Development of Society and Technology*, Mälardalen University, Sweden, 2008; Nik Ab Halim Nik Abdullah, Shahrul Nizam Mohd Zain, “The Internationalization Theory and Malaysian Small Medium Enterprises (SMEs),” *International Journal of Trade, Economics and Finance*, Vol. 2, No. 4, 2011, pp. 318-322.

<sup>18</sup> See: D. Ionescu, “Cluster Development in Transition Countries: A Tool for Small Business Support,” *CEI Workshop on Clusters*, OECD, 2003, available at [<http://www.oecd.org/dataoecd/54/27/17940932.pdf>], 10 December, 2016.

## *Conclusion*

The macroeconomic dynamics of the EAEU countries remains encouraging despite Western sanctions against the Russian economy and high turbulence in the world economic system.

Economic integration is of great importance to the EAEU countries as a mutually beneficial project promoting sustainable economic growth.<sup>19</sup> The single market of the EAEU is extremely important to SMEs because of its combined economic characteristics (see Table 2).

*Table 2*

**Selected Macroeconomic Indicators for the EAEU Countries (1 January, 2015)**

	Russia	Kazakhstan	Belarus	Armenia	Kyrgyzstan	Total
Area, sq km	17,098,246	2,724,000	207,600	29,800	199,900	20,259,546
Population, thousands	143,429.4	17,371.62	9,500.422	3,006.154	5,843.617	179,151.2
Workforce, thousands	75,654.1	8,951.102	4,529.623	1,486.252	2,649.315	93,270.39
GDP, millions of dollars	1,865,328.0	205,417.7	76,126.91	10,878.26	7,267.87	2,157,751.0
GDP per capita, dollars	13,092.99	12,369.43	8,178.998	3,645.542	1,292.062	12,044.3
Exports, millions of dollars	497,764.0	78,237.8	36,392	1,519.3	1,649.9	615,563.0
Imports, millions of dollars	308,027.0	41,212.8	40,787.6	4,401.6	5,732.3	400,161.3
FDI inflows, millions of dollars	20,957.66	9,562.046	1,798.2	382.8	210.5121	32,911.26
Annual inflation, %	7.8	6.7	18.3	2.98	7.5	7.4

*Source:* Compiled using UNCTAD data.

As the partner countries integrate, SMEs can enter their markets more actively, while the market of each individual country, such as Kazakhstan, is limited by both the number of consumers and by their aggregate demand. In addition, national resources cannot fully provide SMEs with all the factors of production required to enhance national competitiveness.<sup>20</sup> At the same time, goods, services, capital and labor can move freely across the EAEU.

However, along with the opportunities offered by the regional market to the SMEs of EAEU member countries, there are also certain problems that require the attention of national governments. For Kazakhstan and its small and medium businesses, a major problem is increased competition from Russia's more competitive economic entities. One can also mention higher duties on some kinds of

<sup>19</sup> See: L.V. Shkvarya, "Rossia v integratsionnykh protsessakh na postsovetskom prostranstve," *Problemy sovremennoi ekonomiki*, No. 4, 2009, pp. 296-298.

<sup>20</sup> See: L.V. Skvarya, "Kontseptualnye osnovy innovatsionnogo predprinimatelstva," *Gorny informatsionno-analiticheskii biulleten (nauchno-tehnicheskii zhurnal)*, No. 5, 2013, pp. 369-372.

goods, such as cars, in the EAEU, with negative consequences for consumers due to rising prices. And this in turn leads to an increase in social unrest and other ethnosocial deviations in the country.<sup>21</sup>

There are also some inconsistencies in standards (technical, financial and others), which makes it more difficult for small and medium-sized enterprises to do business. Finally, the need to join the WTO for Belarus and to comply with WTO rules for Russia, Armenia, Kyrgyzstan and Kazakhstan, which have already joined the organization, requires deliberate efforts by the EAEU member states and the Union as a whole to harmonize and enhance the integration process so as to develop and improve the efficiency of small and medium-sized enterprises in both national and regional markets.

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<sup>21</sup> See: I. Karabulatova, I. Mkrtumova, Z. Polivara, B. Akhmetova, S. Galiullina, E. Loskutova, E. Abylkasymov, "Protest Behavior of Present-Day Russian Youth as Ethnosocial Deviation in an Ethnopolitical Conflict-Prone Situation," *Central Asia and the Caucasus*, Vol. 17, Issue 2, 2016, pp. 94-103.