



TURUN KAUPPAKORKEAKOULU  
Turku School of Economics

*Edited by Kari Liuhto*

External economic relations of Belarus

Electronic Publications of Pan-European Institute 8/2007

# **External economic relations of Belarus**

Edited by Kari Liuhto

## **Contents**

<b>Belarus in a nutshell</b> Kari Liuhto	<b>1</b>
<b>Executive summary</b> Kari Liuhto	<b>12</b>
<b>Authors</b>	<b>17</b>
<b>Keynote address</b> Aliaksandr Milinkevich	<b>20</b>
<b>Economic relations between Belarus and Finland</b> Seija Spiridovitsh	<b>25</b>
<b>Latvia and Belarus: Economic relations</b>	<b>37</b>
<b>Latvia-Belarus economic relations</b> Raita Karnite	<b>47</b>
<b>Lithuania-Belarus economic relations: How the EU accession impacted bilateral relations</b> Romualdas Ginevicius, Manuela Tvaronaviciene, Renata Korsakiene and Kristin Kalasinskaite	<b>72</b>
<b>Polish-Belarusian economic relations as seen from Poland</b> Rafał Sadowski	<b>82</b>
<b>Poland-Belarus economic relations</b> Henryk Borko and David Durkee	<b>94</b>
<b>Lights and shades of Russia-Belarus economic relations</b> Vladimir Sherov	<b>111</b>
<b>Russian investments in Belarus</b> Peeter Vahtra	<b>132</b>
<b>Ukraine-Belarus economic relations</b> Iurii Bazhal	<b>151</b>
<b>A growth triangle between Belarus, Poland and Ukraine: A challenge for cross-border integration at regional level</b> Janek Uiboupin	<b>164</b>
<b>Free economic zones in Belarus: Operations and results</b> Peter Zashev	<b>182</b>
<b>Future options of Belarus</b> Kari Liuhto	<b>200</b>

### Belarus in a nutshell: Some basic facts



#### Land:

Land boundaries: Latvia 141 km, Lithuania 502 km, Poland 407 km, Russia 959 km, and Ukraine 891 km.

Area: 207 600 sq km (slightly smaller than the United Kingdom) – arable land 27%, permanent crops 1%, and other 73%.

Administrative division: 6 provinces and 1 municipality\* – Brest, Gomel (Homyel), Grodno (Hrodna), Mogilev (Mahilyow), Minsk, Vitebsk (Vitsyebsk), and City of Minsk (Horad Minsk)\* (provinces have the same names as their administrative centres).

Natural resources: forests, peat deposits, small quantities of oil and natural gas, granite, dolomite, marl, chalk, sand gravel, and clay.

#### Population:

Population: 10.3 mn –Belarusian 81%, Russian 11%, Polish 4%, Ukrainian 2%, and other 1%.

Labour force: 4.3 mn – agriculture 14%, industry 35%, and services 51% – unemployment rate 1.6%.

#### Energy

Electricity production: 30 bn kWh – production by source: fossil fuel 99.5%, hydro 0.1%, and other 0.4%.

Electricity consumption: 34 bn kWh

Electricity trade: electricity imports 7 bn kWh and electricity exports 1 bn kWh.

Oil production and consumption: production 36,000 bbl/day and consumption 252,000 bbl/day

Oil imports and exports: imports 360,000 bbl/day and exports 14,500 bbl/day

Natural gas production and consumption: production 0.3 bn cu m and consumption 20.5 bn cu m

Natural gas imports and exports: imports 20.5 bn cu m and exports 0 bn cu m

#### Transport network:

Pipelines: natural gas 5223 km – oil 2443 km – refined oil products 1686 km.

Network: railways 5512 km, roads 93 055 km

Source: Central Intelligence Agency, 2007.

## Belarus in a nutshell: The political foundation of Belarus

### Political structure

<b>Official name</b>	Republic of Belarus	
<b>Legal system</b>	The constitution adopted in March 1994 was amended by referendum in November 1996 to increase presidential power and set up a bicameral parliament	
<b>National legislature</b>	Bicameral parliament (National Assembly): upper house, Council of the Republic, with 64 members; lower chamber, House of Representatives, with 110 members	
<b>National elections</b>	October 17th 2004 (legislative); March 19th 2006 (presidential); the next legislative election is due in 2008, and the next presidential election in 2011	
<b>Head of state</b>	President, currently Alyaksandar Lukashenka, elected to a third consecutive term in March 2006 with 83% of the popular vote	
<b>National government</b>	The president appoints the Council of Ministers and has extensive executive powers	
<b>Main political parties</b>	The two main parties supporting the Mr Lukashenka are the Communist Party of Belarus (CPB) and its ally, the Agrarian Party; the liberal opposition consists of the United Civic Party (UCP) and the Belarusian Popular Front Revival (BPF), which are allied with the Party of Communists of Belarus (PCB; not to be confused with the CPB); other opposition parties include the Belarusian Social Democratic Party "Hramada" (BSDP); the main nationalist party is the Christian Conservative Party (CCP), which was formerly a faction in the BPF	
<b>Council of Ministers</b>	<b>Prime minister</b> <b>First deputy prime minister</b> <b>Deputy prime ministers</b>	Syarhei Sydorsky Uladimir Semashko Andrei Kabyakov Alyaksandar Kosinets Ivan Bambiza Viktar Bura
<b>Key ministers</b>	<b>Agriculture &amp; food</b> <b>Defence</b> <b>Economy</b> <b>Education</b> <b>Finance</b> <b>Foreign affairs</b> <b>Industry</b> <b>Interior</b> <b>Labour &amp; social security</b> <b>Trade</b> <b>Transport &amp; communications</b>	Leanid Rusak Leanid Maltsev Mikalai Zaychanka Alyaksandar Radzkov Mikalai Korbut Syarhei Martynav Anatoly Rusetsky Uladimir Naumav Uladimir Patupchyk Alyaksandar Ivankov Uladimir Sosnovski
<b>Central bank governor</b>	Pyotr Prokopovich	

Source: Economist Intelligence Unit, 2007.

## Belarus in a nutshell: President of Belarus, Alyaksandar Lukashenka



- Born:** The village of Kopys, the Vitebsk region, 30.8.1954.
- Education:** Graduated from the Mogilev Teaching Institute in 1975 (a leader of a Komsomol chapter in Mogilev 1977-1978).
- Military service:** Frontier troops (Border Guards of KGB) in 1975-1977 and 1980-1982.
- Work carrier:** A deputy chairman of a collective farm in 1982.
- After graduating from the Belarusian Agricultural Academy, he became the director of the Gorodets state farm and construction materials plant in the Skhov district.
- Political carrier:** A Deputy in the Supreme Soviet of the Republic of Belarus in 1990 (Lukashenka founded a faction called Communists for Democracy).
- In the aftermath of the dissolution of the USSR, Lukashenka briefly returned to management of a state farm.
- Elected as the chairman of the anti-corruption committee of the Belarusian Parliament in 1993. (Lukashenka accused 70 senior government officials of corruption, including Stanislau Shushkevich, the speaker of the parliament).
- Lukashenka was elected as the president of Belarus in first democratic presidential elections in July 1994.
- In the summer 1996, the parliament signed a petition to impeach Lukashenka on charges of violating constitution, however, he managed to escape immediate impeachment with the Russian support. With the help of the November 1996 referendum, Lukashenka close down the Belarusian Parliament and chose his supporters for the new one. The USA and the EU refused to accept the legitimacy of the referendum. The presidential rights extended until 2001.
- Re-election as the president in September 2001.
- A referendum eliminated the presidential term limits in October 2004.
- Lukashenka elected for the third presidential term in March 2006. The West accused that the election was not fair. The EU has frozen the bank accounts of the top Belarusian officials and do not grant them visas to the European Union.

## Belarus in a nutshell: Economic development

### Economic structure

#### Annual indicators

	2002 <sup>a</sup>	2003 <sup>a</sup>	2004 <sup>a</sup>	2005 <sup>a</sup>	2006 <sup>a</sup>
GDP at market prices (BRb bn)	26,138	36,565	49,992	63,679	79,200
GDP at market exchange rate (US\$ bn)	14.6	17.8	23.1	29.6	36.9
Real GDP growth (%)	5.0	7.0	11.5	9.2	9.9
Consumer price inflation (av; %)	42.6	28.4	18.1	10.3	7.0
Population (mid-year; m)	9.9	9.8	9.8	9.8	9.7 <sup>b</sup>
Exports of goods fob (US\$ m)	7,965	10,076	13,942	16,109	19,888 <sup>b</sup>
Imports of goods fob (US\$ m)	-8,879	-11,324	-16,126	-16,610	-22,235 <sup>b</sup>
Current-account balance (US\$ m)	-326	-434	-1,194	434	-1,381 <sup>b</sup>
Reserves excl gold (US\$ m)	619	595	749	1,137	1,099
Exchange rate (official; av; BRb:US\$)	1,790.9	2,051.3	2,160.3	2,153.8	2,144.6

<sup>a</sup> Actual. <sup>b</sup> Economist Intelligence Unit estimates.

Origin of gross domestic product 2005	% of total	Components of gross domestic product 2005	% of total
Agriculture	7.5	Private consumption	53.2
Industry	9.0	Public consumption	19.6
Construction	7.0	Gross fixed capital formation	27.9
Transport & communications	27.4	Increase in stocks	1.7
Trade & catering	9.7	Net exports of goods & services	1.0

Principal exports 2005	% of total	Principal imports 2005	% of total
Mineral products	35.4	Mineral products	33.6
Machinery & equipment	20.3	Machinery & equipment	22.9
Chemicals & rubber	15.0	Chemicals & rubber	12.3
Food & agricultural raw materials	8.3	Food & agricultural raw materials	10.7

Main destinations of exports 2005	% of total	Main origins of imports 2005	% of total
Russia	34.8	Russia	59.3
Poland	4.8	Germany	9.0
UK	4.2	Poland	4.8
Ukraine	4.0	Ukraine	3.9

Source: Economist Intelligence Unit, 2007.

## Belarus in a nutshell: A comparison of Belarus with ex-socialist countries

Transition indicator scores, 2006

Country	Population mid-2006 (million)	Private sector share of GDP mid-2006 (EBRD estimate in per cent)	Enterprises			Markets and trade			Financial institutions		Infrastructure
			Large-scale privatisation	Small-scale privatisation	Governance and enterprise restructuring	Price liberalisation	Trade and foreign exchange system	Competition policy	Banking reform and interest rate liberalisation	Securities markets and non-bank financial institutions	Infrastructure reform
Albania	3.2	75	3	4	2+ ↑	4+	4+	2	3-	2-	2
Armenia	3.2	75	4-	4	2+	4+	4+	2+	3-	2	2+
Azerbaijan	8.3	60	2	4-	2	4	4	2	2+	2-	2
Belarus	9.8	25	1	2+	1	3-	2+	2	2-	2	1+
Bosnia and Herzegovina	3.8	55	3-	3	2	4	4-	2- ↑↑	3-	2-	2+
Bulgaria	7.7	75	4	4 ↑	3-	4+	4+	3-	4-	3- ↑	3
Croatia	4.4	60	3+	4+	3	4	4+	2+	4	3 ↑	3
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4	4-	3+
Estonia	1.3	80	4	4+	4-	4+	4+	4- ↑	4	4- ↑	3+
FYR Macedonia	2.0	65	3+	4	3- ↑	4+	4+	2	3-	2+ ↑	2
Georgia	4.6	70 ↑	4-	4	2+	4+	4+	2	3-	2-	2+
Hungary	10.1	80	4	4+	4-	4+	4+	3+	4	4	4-
Kazakhstan	15.1	65	3	4	2	4	4-	2	3	3- ↑	3- ↑
Kyrgyz Republic	5.1	75	4-	4	2	4+	4+	2	2+	2	2-
Latvia	2.3	70	4-	4+	3	4+	4+	3	4-	3	3
Lithuania	3.4	75	4	4+	3	4+	4+	3+	4-	3	3 ↑
Moldova	3.4	65 ↑	3	4-	2	4	4+	2	3-	2	2+
Mongolia	2.7	70	3	4	2	4+	4+	2	2+	2	2
Montenegro	0.7	65	3+	3	2	4	3+	1	3- ↑	2-	2-
Poland	38.1	75	3+	4+	4-	4+	4+	3	4-	4-	3+
Romania	21.7	70	4-	4-	3- ↑	4+	4+	3- ↑	3	2	3+
Russia	144.1	65	3	4	2+	4	3+	2+	3- ↑	3 ↑	3-
Serbia	8.3	55	3-	4- ↑	2+	4	3+	2- ↑↑	3-	2	2
Slovak Republic	5.4	80	4	4+	4-	4+	4+	3+	4-	3 ↑	3-
Slovenia	2.0	65	3	4+	3	4	4+	3-	3+	3-	3
Tajikistan	6.5	55	2+	4	2-	4-	3+	2-	2+ ↑	1	1+
Turkmenistan	6.5	25	1	2	1	3-	1	1	1	1	1
Ukraine	47.1	65	3	4	2	4	4-	2+	3 ↑	2+	2+ ↑
Uzbekistan	26.0	45	3-	3+ ↑	2-	3-	2	2-	2-	2	2-

Source: EBRD.

Note: The transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialised market economy. For a detailed breakdown of each of the areas of reform, see the methodological notes on page 198.

The private sector share of GDP is calculated using available statistics from both official (government) and unofficial sources. The share includes income generated from the formal activities of registered private companies as well as informal activities where reliable information is available. The term "private

company" refers to all enterprises in which private individuals or entities own the majority of shares.

The accuracy of EBRD estimates is constrained by data limitations, particularly in the area of informal activity. EBRD estimates may, in some cases, differ markedly from official data. This is usually due to differences in the definition of "private sector" or "non-state sector". For example, in the CIS, "non-state sector" includes collective farms as well as companies in which only a minority stake has been privatised.

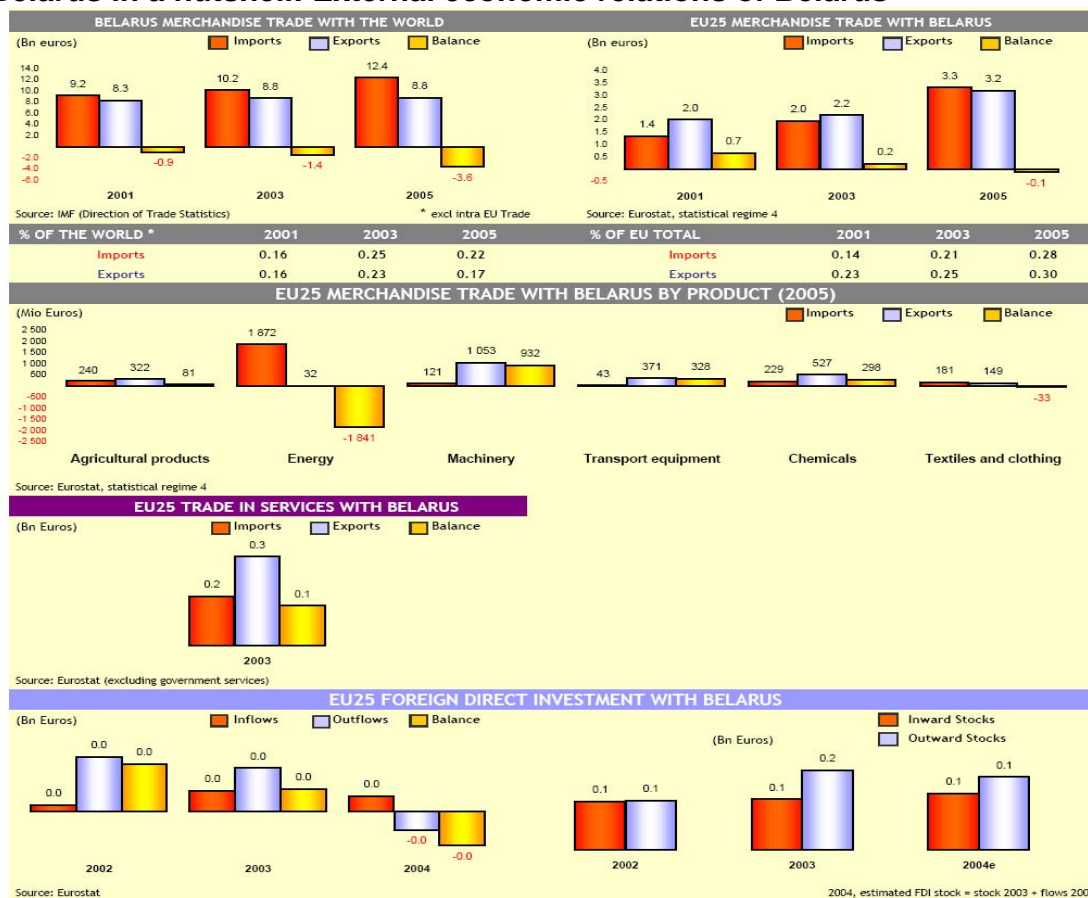
↑ and ↓ arrows indicate change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example), two arrows a movement of two points. Up arrows indicate upgrades, down arrows downgrades.

Past scores for the following have been revised this year: governance and enterprise restructuring for Azerbaijan, price liberalisation for FYR Macedonia and Moldova, trade and foreign exchange systems for Kazakhstan and Serbia, and competition policy for Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovak Republic.

Source: European Bank for Reconstruction and Development, 2006.



## Belarus in a nutshell: External economic relations of Belarus



(2005)

### European Union, Imports from ... Belarus

rank	SITC Rev.3 Product Groups	Mio euro	Share of total EU imports	%
45	TOTAL	3 343	0.28	100.0
54	Agricultural products	240	0.30	7.2
20	Energy	1 874	0.75	56.1
26	Non-agricultural raw materials	14	0.87	0.4
61	Office/telecom. Equipment	4	0.00	0.1
32	Power/non-electrical mach.	105	0.15	3.1
66	Transport equipment	43	0.04	1.3
30	Chemicals	232	0.25	6.9
34	Textiles and clothing	182	0.26	5.4
23	Iron and steel	182	1.17	5.4

### European Union, Exports to ... Belarus

rank	SITC Rev.3 Product Groups	Mio euro	Share of total EU exports	%	Balance
43	TOTAL	3 220	0.30	100.0	-124
36	Agricultural products	322	0.52	10.0	82
53	Energy	32	0.08	1.0	-1 843
40	Non-agricultural raw materials	21	0.04	0.6	7
46	Office/telecom. Equipment	207	0.22	6.4	203
41	Power/non-electrical mach.	684	0.42	21.2	579
47	Transport equipment	371	0.22	11.5	328
39	Chemicals	528	0.32	16.4	296
34	Textiles and clothing	149	0.45	4.6	-33
68	Iron and steel	18	0.09	0.6	-163

Share by products in EU 25 Total Trade excluding Intra-EU trade.

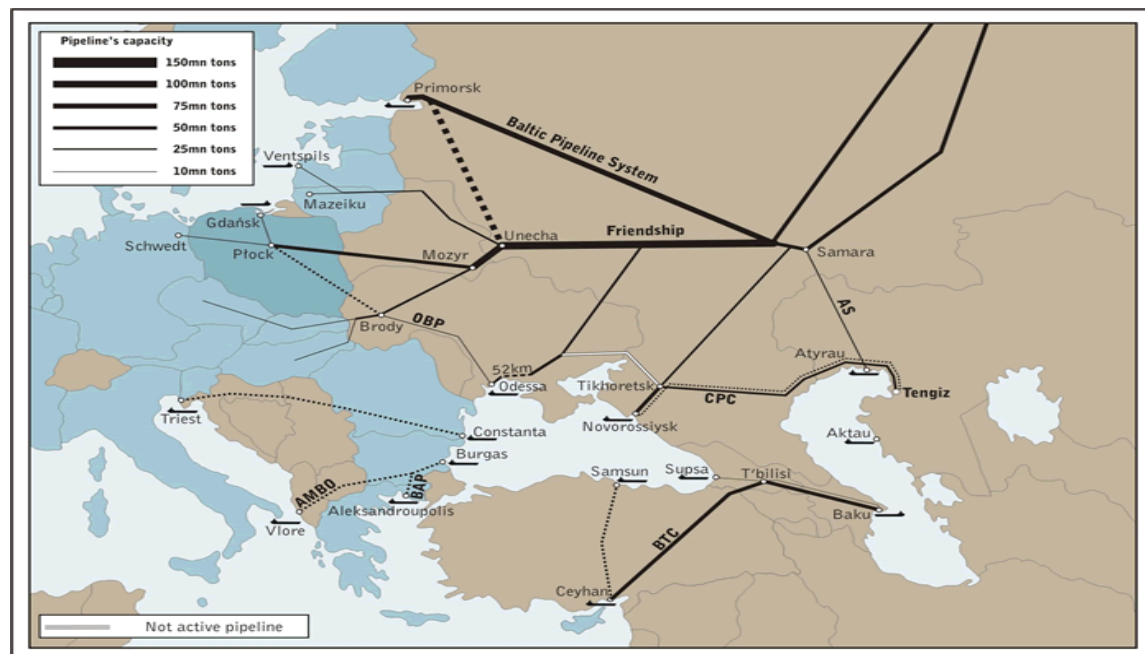
Source: European Commission, 2007.

## Belarus in a nutshell: Natural gas and oil pipelines via Belarus

### Natural gas pipelines



### Oil pipelines



Source: Centre for Eastern Studies, 2007.

## Belarus in a nutshell: The significance of Belarus as natural gas gateway

Chart 1. Production and export of Russian gas

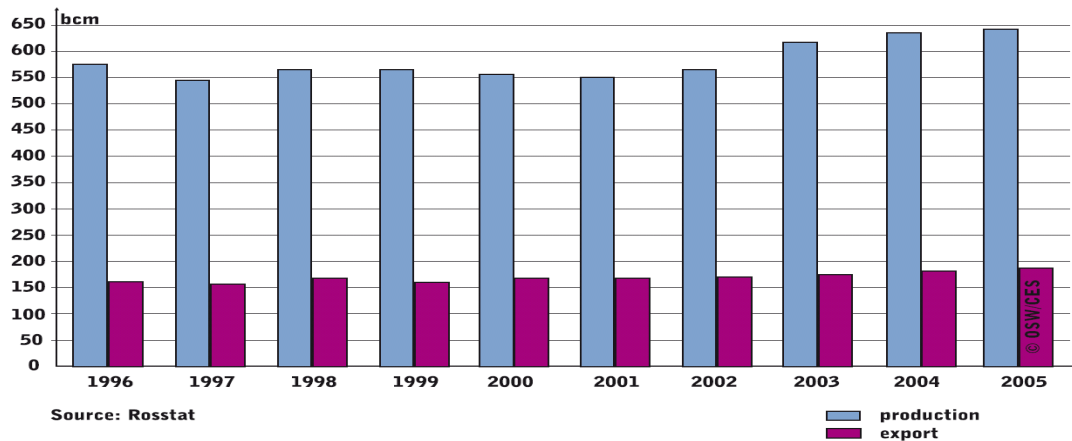


Chart 2. Major consumers of Russian gas

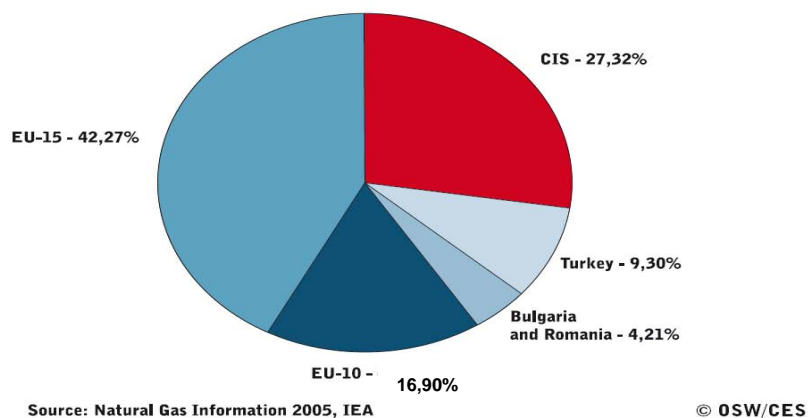
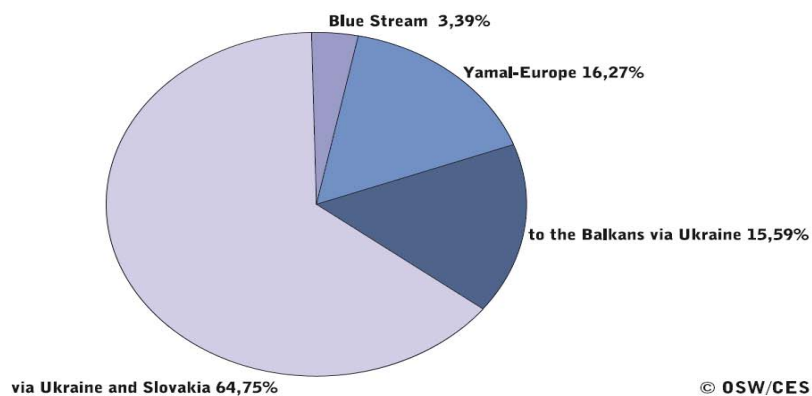


Chart 3. Russian gas: Export routes to Europe



Source: Centre for Eastern Studies, 2006.

## Belarus in a nutshell: Gazprom's natural gas sales in 2005

	Volume	Share of total sales
<b>Domestic sales (Russia)</b>	<b>540 bcm</b>	<b>57%</b>
<b>Foreign sales</b>	<b>233 bcm</b>	<b>43%</b>
EU (27)	140 bcm	26%
Turkey	18 bcm	3%
CIS	71 bcm	13%
Others	4 bcm	1%
<b>Main export destinations</b>		
	<b>Volume</b>	<b>Share of foreign sales</b>
1 Ukraine	37,6 bcm	16%
2 Germany	36,0 bcm	15%
3 Italy	22,0 bcm	9%
<b>4 Belarus</b>	<b>19,8 bcm</b>	<b>9%</b>
5 Turkey	18,0 bcm	8%
6 France	13,2 bcm	6%
7 Hungary	9,0 bcm	4%
8 Slovakia	7,5 bcm	3%
9 Czech Republic	7,4 bcm	3%
10 Poland	7,0 bcm	3%
11 Austria	6,8 bcm	3%
12 Romania	5,0 bcm	2%
13 Finland	4,5 bcm	2%
14 Netherlands	4,1 bcm	2%
15 Kazakhstan	4,0 bcm	2%
Others (17)	30,8 bcm	13%

## Gazprom contract prices for select countries, 2005–2007, US\$/1,000 m<sup>3</sup>

Country	2005	2006	2007
Western Europe	174*	250*	260**
Germany	200	250	n.a.
Azerbaijan	60	110	235**
Georgia	68	110	235
Slovakia	180	n.a.	n.a.
Slovenia	180	n.a.	n.a.
Poland	120	n.a.	n.a.
Latvia, Lithuania, Estonia	90*	123*	240*
Moldova	80	160	170
Ukraine	50	95	130
Armenia	56	110	110
Belarus	47	47	100

\* Average; \*\* Preliminary information

Figures compiled from several news sources.

Sources: Gazprom 2006, Troika Dialog 2006, Der Spiegel 2006; Bank of Finland 2007

## Belarus in a nutshell: The development of the FDI stock in selected countries

Region/economy	FDI inward stock			FDI outward stock		
	1990	2000	2005	1990	2000	2005
<b>World</b>	1 789 303	5 802 991	10 129 739	1 791 092	6 471 435	10 671 889
<b>Developed economies</b>	1 418 867	3 976 233	7 117 110	1 642 187	5 578 341	9 271 932
<b>Europe</b>	815 205	2 297 802	4 731 293	887 324	3 643 046	6 244 371
<b>European Union</b>	768 160	2 179 706	4 499 128	810 277	3 050 067	5 475 025
Austria	10 972	30 431	61 344	4 747	24 821	67 243
Belgium and Luxembourg	58 388	195 219	..	40 636	179 773	..
Belgium	..	..	492 330	..	..	386 294
Cyprus	.. <sup>a,b</sup>	2 910 <sup>a</sup>	8 768	8 <sup>a</sup>	560 <sup>a</sup>	3 038
Czech Republic	1 363 <sup>a</sup>	21 644	59 459	..	738	4 239
Denmark	9 192	73 574	101 568	7 342	73 106	118 104
Estonia	..	2 645	12 274	..	259	1 968
Finland	5 132	24 272	52 821	11 227	52 109	74 413
France	86 845	259 776	600 821	110 126	445 091	853 159
Germany	111 231	271 611	502 790 <sup>a</sup>	151 581	541 861	967 298 <sup>a</sup>
Greece	5 681 <sup>a</sup>	14 113	29 312	2 882 <sup>a</sup>	6 094	13 345
Hungary	569	22 870	61 221	197	1 280	6 604
Ireland	56 512 <sup>a</sup>	127 089	211 190 <sup>a</sup>	17 204 <sup>a</sup>	27 925	117 909 <sup>a</sup>
Italy	59 998	121 170	219 868	60 184	180 275	293 480
Luxembourg	..	23 492	69 383 <sup>a</sup>	..	7 927	49 415 <sup>a</sup>
Latvia	..	2 084	4 783	..	24	294
Lithuania	..	2 334	6 461	..	29	708
Malta	465 <sup>a</sup>	2 385	4 195	..	203	859
Netherlands	68 731	243 733	463 416	106 899	305 461	641 259
Poland	109	34 227	93 329 <sup>a</sup>	408 <sup>a</sup>	1 018	4 671 <sup>a</sup>
Portugal	10 571	32 044	64 517	900	19 552	44 457
Slovakia	81	3 733	15 324 <sup>c</sup>	..	325	538 <sup>c</sup>
Slovenia	665 <sup>a</sup>	2 894	8 064 <sup>a</sup>	258	768	3 607 <sup>a</sup>
Spain	65 916	156 348	367 656	15 652	167 719	381 319
Sweden	12 636	93 970	171 517	50 720	123 230	202 805
United Kingdom	203 905	438 631	816 716	229 307	897 845	1 237 997
<b>Other developed Europe</b>	47 045	118 095	232 165	77 047	592 979	769 346
Gibraltar	263 <sup>a</sup>	529 <sup>a</sup>	980 <sup>a</sup>	..	..	..
Iceland	146	497	3 842	76	664	9 479
Norway	12 391	30 265	54 853 <sup>a</sup>	10 884	362 574	365 113 <sup>a</sup>
Switzerland	34 245	86 804	172 489	66 087	229 741	394 754
<b>CIS</b>	9	55 223	199 151	..	20 884	123 719
Armenia	9 <sup>a</sup>	632	1 225 <sup>a</sup>	..	3 <sup>a</sup>	32 <sup>a</sup>
Azerbaijan	..	3 735	13 876	..	474 <sup>a</sup>	3 686
Belarus	..	1 306	2 383	..	24	14
Georgia	..	730	2 320	..	..	..
Kazakhstan	..	10 078	25 152	..	16	.. <sup>b</sup>
Kyrgyzstan	..	447	522	..	33	60
Moldova, Republic of	..	439	1 129	..	23	28
Russian Federation	..	32 204	132 491 <sup>a</sup>	..	20 141	120 417 <sup>a</sup>
Tajikistan	..	136 <sup>a</sup>	522 <sup>a</sup>	..	..	..
Turkmenistan	..	944 <sup>a</sup>	1 360 <sup>a</sup>	..	..	..
Ukraine	..	3 875	17 209	..	170	466
Uzbekistan	..	699 <sup>a</sup>	964 <sup>a</sup>	..	..	..

Source: United Nations Conference on Trade and Development, 2006.

## Executive summary

Belarus is widely known for her notorious political situation and the recent energy conflict with Russia. However, only few know Belarus' economic foundations, and hence the country's true competitiveness. In order to fill this knowledge gap, the research in hand aims at analysing the country's true competitiveness via studying Belarus' external economic relations, as the foreign economic relations of a relatively small country is a rather appropriate indicator of the country's real competitiveness. ***By analysing Belarus' true competitiveness this study tries to predict what might occur in Belarus, when the country's politico-economic transformation begins.***

Here, one should emphasise that Belarus has not even started her economic reform. A clear indication of the postponed transformation is the fact that the private sector forms only 25% of the Belarusian GDP, or even less<sup>1</sup>. In her neighbouring countries, the private sector represents 65-75% of their GDP, being lowest in Russia and Ukraine, and correspondingly, highest in Lithuania and Poland (EBRD, Transition report, 2006).

Only Turkmenistan among all the post-Soviet republics has as low a private sector share as Belarus. Perhaps, the major difference between these two authoritarian state-dictated economies is the fact that peripheral Turkmenistan has significant natural gas reserves, while Belarus has not been blessed with considerable natural resources, except her geographical location; Belarus is situated almost in the heart of the European continent, i.e. at the crossroads between Russia and the EU and Northern and Southern Europe.

Analysing the true competitiveness of Belarus is an utmost acute theme since the country is forced to pay the market price for her natural gas imports from Russia in 2009. Increasing energy bill forces Belarus to reform her economic structures, as Russia has indicated that she will no longer subsidise Belarus with inexpensive energy deliveries. Moreover, the possible re-routing of oil pipeline from the Belarus border to Primorsk on the Gulf of Finland, and the building of a major natural gas pipe on the bottom of the Baltic Sea to Germany will definitely have a major impact on the position of the Lukashenka regime.

Furthermore, Russia's possible WTO membership in 2007-2009 would put extra pressures on Belarus, since after Russia's accession to the WTO the special relationship between Russia and Belarus is likely to disappear or at least change its character fundamentally. For instance, it is most likely that the shadow imports to Russia via Belarus, including the imports via the Belarusian free economic zones, will be stopped.

Russia's growing investment in the Belarusian strategic industries strengthens the Russia's grip over Belarus. Gazprom's acquisition plan over Beltransgaz is one clear piece of evidence on increasing Russian business dominance in Belarus. In addition to Beltransgaz, the Russian firms eye the two Belarusian oil refineries (Mozyr and Novopolotsk), banks, and telecommunication firms<sup>2</sup>.

---

<sup>1</sup> According to Belarusian experts' estimates, the private share is actually about 12% of the GDP (Centre for Eastern Studies, Belarus 2006, 2007).

<sup>2</sup> "On 27 February [2007], the press reported that the Belarusian Ministry of Economy was working on a plan to sell minority stakes in the largest state-owned enterprises, including the Naftan and

All the aforementioned factors indicate that Russia either pushes the Lukashenka regime to a closer co-operation (even forces Belarus to integrate into Russia), or alternatively, Russia may aim at changing the Belarusian leadership by decreasing Lukashenka's popularity with various politico-economic means in 2011, when Belarus' next presidential elections are scheduled, or even earlier. ***Russia's economic siege around Belarus stresses the need of the decision-makers in the EU and beyond to be better informed about the economic realities of Belarus.***

In order to contribute to this information collection process, a group of nearly 20 academics have combined their efforts to give their view on contemporary Belarus. The researchers represent all the neighbouring countries of Belarus plus Finland, which have been included in the report as an example of economic relations between Belarus and a non-former socialist country.

The report lacks the official view from Belarus since the Ministry of Foreign Affairs of Belarus failed to deliver the promised contribution, and the papers received from the Belarusian academia did not meet the quality criteria of this report. Luckily, however, we managed to obtain a view of Dr. Aliaksandr Milinkevich, the main figurehead of the Belarusian opposition. Even if his view probably differs from the official standpoint of the Belarus, it nevertheless gives us a perspective on the complex political situation in Belarus.

In order to aid a reader to familiarise himself/herself with Belarus' political and economic background, a 10-page information package 'Belarus in a nutshell' have been included before the expert articles.

The article on the Belarus-Finland economic relations starts the series of the papers on the bilateral relations of Belarus. The author of this article concludes that the trade turnover between Finland and Belarus is small and investments virtually non-existent, but there are several sectors where the Finnish and Belarusian firms could find mutual interest. However, before putting money into larger projects, foreign investors need to get necessary investment guarantees. In addition, the article stresses that the regulatory framework in Belarus is far too complicated. One could summarise the core policy recommendation of the paper as follows; less bureaucracy and regulations Belarus sets, more foreign investment and economic growth Belarus gets. The writer ends her article by stating that the rising cost of energy over the following years highlights the vast needs to restructure the Belarusian economy, and to increase exchange of knowledge and experience with her neighbours. The writer wishes that changes in the business environment will prove to be a catalyst for Belarus for embarking on a reform bath and opening up for deeper co-operation with its western partners, Finland being among them.

Two contributions on the Latvian-Belarusian relations indicate that the bilateral trade is unjustifiably low for neighbouring countries, but there are major opportunities for increasing

---

*Mazyr refineries, the Polimir petrochemical plant, Belshyna, Grodno Azot, the MAZ automotive plant, the telecom monopoly Beltelecom, the Nemen tobacco plant, the Krynitsa Brewery and the Minsk Wine Factory. As yet, no details of the project have been revealed, and the numbers of shares to be offered for sale have not been set."* (Centre for Eastern Studies, EastWeek 9(74), 2007, 2).



trade. In addition, these papers reveal that although the Latvian economy is small, the Latvian companies are active in investing in Belarus. A noteworthy finding is the fact that large Latvian corporations have been rather successful, while smaller firms have encountered bureaucratic difficulties in Belarus. These articles state that tourism plays a small role in the bilateral relations between Latvia and Belarus. These articles reveal also an interesting fact that Belarus is the second largest transit partner for Latvia, as Belarusian firms transport significant amounts of potassium salt and oil products via the Latvian ports.

The paper from Lithuania stresses that the bilateral trade between Lithuania and Belarus has steadily grown despite Lithuania's accession to the EU in May 2004. The Lithuanian imports from Belarus consist chiefly on natural resources, oil accounting for over a half of the deliveries from Belarus. On the export side, Lithuania sells mainly manufactured goods.

Two articles on the Poland-Belarus economic relations indicate that Poland plays a significant role in the Belarusian external economic relations. In 2006, Poland ranked the fifth among the largest foreign trade partners of Belarus. Due to the proximity of the two countries, also informal trade has emerged, i.e. small amounts of goods cross the border to be re-sold on the other side. One of the articles argues that such informal trade may amount to approximately 30% of the total trade between the two countries. In addition to the bilateral trade, also other fields of economic collaboration may emerge, such as eco-tourism and health vacations, if the borders are open enough, and hence, the authors recommend that the EU should concentrate on developing policies that make the border more accessible for the local traffic and inhabitants.

Also two articles study Russia's multisided relations with Belarus. In the first article, the writer argues that the recent energy conflict between Belarus and Russia worsens their relations in short run, but brings this relationship on a more rational basis in the medium-term. Besides, he discusses the possible impact of Russia's WTO accession on Belarus. The second article on the Belarus-Russia economic relations deals with the Russian investments in Belarus. The author concludes that Russia is the largest foreign investor in Belarus with a share of 80% of the Belarusian annual FDI inflows during the recent years. The recent energy dispute and subsequent deterioration of the relationships between Russia and Belarus are likely to yield more strategic acquisitions by Russian companies in Belarus. The writer argues that the increasing Russian business presence in Belarus holds increasing stabilisation on one hand, but increasing dominance of Russia over her energy supplies, on the other. The growing uncertainty over Russian energy deliveries and supply disruptions similar to those witnessed in the beginning of the previous years, are hardly in the interest of the EU. The key issue to be considered by the European policy-makers is at which point does the stability provided by Russia's control over her energy supplies and assets in the region turn into economic and political supremacy.

The article on the Ukrainian-Belarusian economic relations concludes that the bilateral economic relations between Ukraine and Belarus are not particularly intensive. Belarus accounts for a bit less than 3% of the Ukrainian foreign trade, while Ukraine represents some 5% of the Belarusian external trade. The paper suggests that the CIS countries do not have strong economic incentives to co-operate between each other after the disintegration of the USSR, if one excludes the energy-related trade. The writer discovers that a major shift in the Belarusian foreign trade from the CIS to other countries could be



observed during the past few years. In 2000, 60% of the Belarus foreign trade was conducted with other CIS countries, whereas five years later, the CIS accounted for 44% of her foreign trade. The article reveals that the bilateral investments and tourist flows between Belarus and Ukraine are still relatively insignificant.

The article on the trilateral regional co-operation describes the co-operation between neighbouring regions of Belarus, Poland and Ukraine. The author recommends that the infrastructure for trade and tourism should belong to the top priorities of the border regions, as the roads and border crossings are below modern standards. Academic institutions should be more integrated into regional planning to increase the absorptive capacity and better manage financial aid from the EU Neighbourhood Programme. Environmental collaboration is also a very important field for future cross-border co-operation. Author tentatively suggests visa-free travel between countries in case of short visits. In general, the author finds that the growth triangle between Belarus, Poland and Ukraine has a lot of unused potential for future development. A lower level integration, i.e. the regional co-operation, is most needed under the current conditions when the political and diplomatic relations between Belarus and the EU are far from optimal at the higher level.

The paper on the free economic zones (FEZs) in Belarus concludes that the FEZs have been rather disappointing in their performance. The total amount of foreign investments accumulated by the FEZs represents some 17% of the extremely modest total Belarusian FDI stock for the period between 2001 and 2006. Furthermore, the Belarusian FEZs account for less than 4% of the total Belarusian exports. The author concludes that the FEZs' main activities are to import goods from the non-CIS countries, to process them, and later to export them to the CIS countries in general, and Russia in particular. In other words, the Belarusian FEZs have become gateways to Russia, which allow foreign products to enter the Russian market without customs fee. The future of these gateways is uncertain, if there is a further political drift between the two countries. The author indicates that the EU and Russia are the main potential sources of foreign investments, but the author does not foresee any major change related to foreign investment inflow unless Belarus' political relations with the EU and Russia improve.

At the end of this report, Liuhto describes five future scenarios for Belarus, namely North-Korean path, the model of China, the European way, the model of the Karelian Republic, and a non-dependent country in-between. The first scenario is based on the hypothetical assumption that Belarus would break her relations with both the EU and Russia. North-Korean path would lead to the isolation of Belarus, deteriorating living standards, and finally to coup d'état sooner or later. The Chinese model is based on starting the economic reform accompanied with gradual political liberalisation. As partial political reforms are not sustainable solutions, accumulating social pressure would lead to the European way, the model of the Karelian Republic or a non-dependent country in-between at the end. The adoption of the European way would require Lukashenka to allow a full political and economic liberalisation to take place in the country. The model of the Karelian Republic assumes Belarus becoming a part of the Russian Federation. If the Karelian Republic scenario comes to existence, it can be expected that the Kremlin use decisive measures to replace the Lukashenka regime and the Belarusian oligarchy, and replaces them with more obedient leaders to the Kremlin. The fifth scenario assumes that Belarus does not belong neither to the sphere of influence of Russia nor the EU. A successful non-dependent country in-between status requires that Belarus is reliable partner for both the

EU and Russia, and hence, the EU and Russia should have a common goal over Belarus. Both of them ought to support political and economic liberalisation in Belarus.

The editor wishes to give a special thanks to Poland's Embassy in Helsinki and Latvia's Embassy in Minsk for their aid. The research funding from the Academy of Finland and Foundation for Economic Education (Liikesivistysrahasto) is gladly acknowledged.

The report is freely downloadable at the site of the Pan-European Institute ([www.tse.fi/pei/e](http://www.tse.fi/pei/e)).

April 12-14<sup>th</sup> 2007, Turku

Professor Kari Liuhto  
Director  
Pan-European Institute

## Authors

**Abel Adekola**, Dr., Professor, Fulbright Scholar, University of Wisconsin, Professor of International Management and Visiting Professor of Strategic management at the Carlson School of Management of the University of Minnesota, USA.

**Iurii Bazhal**, Doctor of Science (Economics), Professor, Head of Economics Department at the National University of Kyiv-Mohyla Academy, Senior Research Fellow of the Institute of Economics and Forecasting at the Ukrainian National Academy of Sciences.

**Henryk Borko** is a UNIDO Expert in Warsaw. Borko specializes in Lithuania, Belarus, Ukraine, Uzbekistan, and Moldova. He lectures at the Warsaw School of Economics on the topics related to eastern economies with a special consideration given to the role of FDI and cross-border cooperation.

**David Durkee** is a Lecturer at the University of East London. He teaches international development in the Third World Programme. His research areas include FDI, energy, China, economic development and recipient perspective. Durkee is a co-convenor of EADI Multi-Dimensional Poverty Working Group.

**Romualdas Ginevicius**, Habil. Dr., Professor, Rector of Vilnius Gediminas Technical University. His research interests are organisation theory, economics of enterprises, and international business.

**Kristina Kalasinskaite**, Doctoral Student at Vilnius Gediminas Technical University. She teaches business economics.

**Raita Karnite**, Dr. Econ., holds position of Director of the Institute of Economics, the Latvian Academy of Sciences. She is Academician of the Latvian Academy of Sciences. Her research work focuses on various fields such as macroeconomic development, sectoral development (industrial sectors, culture and tourism economics, information and knowledge society), EU integration issues, industrial relations and social reforms.

**Renata Korsakiene**, Dr., Associate Professor at Vilnius Gediminas Technical University. She teaches strategic management.

**Kari Liuhto** received his Ph.D. (Social Sciences) from the University of Glasgow and the degree of Doctor of Science (Economics) from the Turku School of Economics. Liuhto holds a professorship in International Business and he is Director of the Pan-European Institute. His research interests include the EU-Russia economic relations, energy relations in particular, the investments of Russian firms abroad, and the strategic development plans of the Russian Federation. Liuhto has been involved in several Russia-related projects funded by the European Commission, the European Parliament, the United Nations, the World Bank, the Finnish Ministries, the Academy of Finland and major international corporations.

**Aliaksandr Milinkevich**, Dr, Leader of the Movement for Freedom in Belarus. Milinkevich was elected in late 2005 by the Congress of Democratic forces of Belarus, and he ran as a candidate of the united democratic forces in the 2006 presidential election in Belarus. Since 1996 Milinkevich was Programme Manager of the Foundation for Assistance to Local Development. He served as a vice-chairman of Hrodna city executive committee in charge of education, culture, religion, health protection, mass media, international relations, sports, and youth. Milinkevich is Professor of Physics. He is author of 65 scientific works on quantum electronics, laser technical equipment, history of culture, education, architecture and technical equipment. Milinkevich is the winner of the European Parliament's 2006 Sakharov Prize for Freedom of Thought. Milinkevich has received the Order of Merits for Polish Culture for the discovery of the burial place of Stanislaw Poniatowski, the last king of the Kingdom of Poland and the Grand Duchy of Lithuania.

**Rafał Sadowski** is an Analyst for the Department for Ukraine, Belarus and the Baltic States of the Centre for Eastern Studies in Warsaw, Poland. He received his M.A. in the Centre for East European Studies of Warsaw University. His field of expertise includes internal situation and foreign policy of Belarus, the EU's relations with the Eastern European states, cross-border cooperation in Eastern Europe, social changes in Belarus and Ukraine, and Turkish foreign policy.

**Vladimir Sherov**, Ph.D., is an Associate Professor at the St. Petersburg State University, Faculty of Economics, Department of World Economy since 1995. His courses include the world economy, the regional integration, the economic systems of the USA and Canada, and Russia-EU economic interaction. Sherov delivers lectures for international students about Russia's business geography and problems of the CIS. The regional integration is the main sphere of his interest and topic of his publications.

**Seija Spiridovitsh** received her M.A. at the University of Jyväskylä in 1978. She completed Fintra International Business School (Export Manager) in 1981. Her expertise areas are business intelligence, international marketing, Russia, the CIS, Baltic and Balkan countries. She has 28 years' experience in business relations with the Central and Eastern European countries. For the time being, she is a Business Analyst at Finpro - a consulting network accelerating the internationalisation of the Finnish companies.

**Manuela Tvaronavičienė**, Dr., Professor at Vilnius Gediminas Technical University. She teaches business economics and organisation theory.

**Janek Uiboupin** is a Post-Doc. Researcher of the Pan-European Institute at the Turku School of Economics, Finland. He received a Ph.D. degree from the University of Tartu, Estonia in 2005. His research concentrates on cross-border cooperation and regional development, financial sector development and foreign banks' entry in Central and Eastern Europe.

**Peeter Vahtra** works as a Researcher at the Pan-European Institute, Turku School of Economics, Finland. His research focus areas are foreign investments and operations of the Russian companies, the Russian energy sector, and the business-state interaction in Russia.

**Peter Zashev** is a Senior Research Fellow at the Pan European Institute of Turku School of Economics. His expertise includes business opportunities in Russia and former socialist countries and cross-cultural business skills development. Dr. Zashev is one of the leading experts on the Russian business culture in Finland.

## **Keynote address**

Aliaksandr Milinkevich

Belarus is a new nation-state in the centre-east Europe. Throughout the history it exchanged thoughts, human resources and goods with other European countries. Over centuries many Belarusians have been contributing to the development European ideas, science and culture.

Unfortunately during last two centuries Belarus' relations and contacts with European countries were not developing at full scale. The regime that exists in Belarus at the moment has also been trying to build the fence between Belarusians and Europe. Sometimes it seems that this fence is nearly turning to new "iron curtain" – the worst that could happen to my country. Unfortunately, quite often Western countries contributed to resurrection of this "fence", neglecting Belarus and the problems the emerging civil society faces in my country. This attitude is rapidly changing though, especially after presidential elections of 2006. We can say that despite the regime's self-isolation from Europe Belarus is becoming more and more exposed to it. We hope that our European neighbours are increasingly realising that Belarus is not Lukashenka.

There are natural changes within the Belarusian society. Lukashenka's social basis is narrowing. Whatever money he is putting to enforcement bodies new threats to the regime are emerging. Last year street protests, especially overt standing against the regime in the central square of Minsk clearly proved the main driving force was represented by our young people. They are new generation of voters. They are worthy people who want changes and are ready to act for them. According to independent polls at March 2006 elections democratic candidates got support of 30% of voters. We managed to achieve a consolidation of democratic electorate, of all those who want changes and stand for independence, democracy and European choice for Belarus.

The year after the elections proved that the Lukashenka's model of development for Belarus obviously leads to a deadlock. The feeling of prosperity and stability that is obstinately imposed to the society by the official propaganda is shallow since it is based on lack of information. There is an increasing number of Belarusians that realise what is the real cost of the 'stability' paid by the country. We found ourselves in a critical stage of wear and tear of main production assets. Because of unfriendly investment climate we lack money for modernising our economy. Oil and gas conflict with Russia has showed that the Belarusian economy is not ready at all to operate with world prices on gas and oil. Belarus is becoming an appendix of raw materials-based economy of Russia. Some prosperity that we have achieved has been mainly based on oil products exports and cheap gas price.

But profits acquired thanks to favourable prices on Russian oil and gas were not spent on modernising agriculture, food processing industry or implementing energy saving technologies. They were spent on immediate consumption and strengthening the repression mechanisms – secret services, special task forces and army. This 'subsidy' has been for years strengthening not the Belarusian economy but the Belarusian regime. Another question that arises – was it actually a subsidy? What does Belarusian regime provides Russia with in exchange?

Nowadays the relationship of the two countries are totally obscure; 'grey schemes' prevail in many spheres, providing ground to speculations from both sides. We have to bring this to an end, ensuring that relations benefit our nations, not ruling clans. In order to do this we need to forget propagandistic invention 'union and Belarus and Russia' and seek to create a genuine free trade zone based on WTO rules. Up to this date, most of trade related agreements are still on paper only. Over 500 product groups cannot be traded freely between Belarus and Russia. We also need to carry out a full scale inventory of all transfers and among Belarus and Russia in all spheres: trade, transit, armed forces etc. All transfers should be regulated and monetarised in accordance with international practice and market prices. Belarusian companies should pay market prices for Russian oil and gas as well as Russian companies should pay market prices for transit of their goods via Belarus. This will bring transparency to our bilateral relations and put an end to speculations about who is subsidising whom.

So, main goals of the Belarusian reform-oriented forces are free election, democracy, independence, European choice for Belarus. These objectives were set not only when we were entering into the electoral struggle with Lukashenka but are result of a long historic struggle for Belarusian statehood and democracy. Today these objectives are even more pressing. For us, the European choice is not only the choice of better life conditions or modern technologies. It is our civilisation choice. My country belongs to Europe, we want it to share fully European values of democracy and civil society. I strongly believe that Belarusians will soon make choice for freedom, parliamentary democracy, rule of law, respect for human rights and a model of relationship between the person and the state based not on a submission but on a partnership and mutual respect.

The united Europe that is built on these values is a natural gravitation centre for Belarusians. The EU as a whole and its member-states have an increasing influence and leverage on Belarus. The EU has declared that it keeps the door open for dialogue with the regime. The preconditions for starting such dialogue are very well known: release of all political prisoners, democratisation of electoral law, freedom of speech. I personally wrote a letter to Lukashenka saying that if these conditions are met I will be the first to ask for an improvement of relations between Belarus and Europe. It is to Lukashenka to make his choice. Unfortunately, latest facts of political repressions, especially in relation to young activists, show us that Lukashenka's regime is not willing to take the hand extended by the EU and start democratisation process in Belarus. Europeans should judge changes in Belarus or Lukashenka's behaviour from deeds not promises.

At the same time, I hope the regime's reluctance would not prevent the EU from playing a prominent positive role in helping to bring Belarus back to the European family of free nations. The EU should realise that it has an interest in supporting its friends within Belarus by offering them tangible benefits from co-operation and bypassing the regime's obstacles. For that end, the various Belarusian domestic pro-European interest groups and political structures are to be engaged in a dense network of contacts and common programmes. There is huge potential for cooperation between Belarusian and European NGOs and political parties. The Belarusian society needs more knowledge in democracy, human rights and market economy. European NGO could promote co-operation in the



fields of educational exchanges, twinning, rehabilitating victims of Chernobyl, helping disabled persons and kids with no parents. Co-operation can be strengthened in the fields of environmental and historical heritage protection. There are such common problems to resolve as international organised crime and human trafficking.

The EU can have an impact on Belarusian economic actors since the enlarged EU absorbs more than half of the Belarusian exports. Today, the economic relations of Belarus with the EU countries are one-sided and obviously underdeveloped. They are limited mostly to exchange of goods and, moreover, mineral products constitute the major part of Belarusian exports to EU countries. Investment activities of foreign companies are unsatisfactorily low due to unfavourable investment climate. There could not be due respect for private property in an authoritarian state. Until Lukashenka is in power no foreign investor, coming from either West or East, cannot be guaranteed that his property will not be expropriated. Besides that the regime perceives direct foreign investment as a considerable threat to its own sustainability. Opening our economy to foreign investment, technologies and business culture should be one of the main tasks of reform-oriented forces. Besides, this is the only way for a small and export-oriented economy like Belarus to survive in highly competitive environment.

There are lots of new challenges for Belarus due to the EU 2004 enlargement. Belarus' neighbours that joined the EU start lacking labour force in labour-intensive industries as citizens of these countries go to work in older EU member countries. Poland has already begun actively attract builders and seasonal agricultural workers from Belarus. Obviously, we need a balanced policy in this field. This is particularly important nowadays when hundreds of regime opponents are laid off studies and work. Study and employment opportunities in the West are the last resort for many of them.

Last year 7% of Belarusians visited EU countries. This is probably more than it used to be, but obviously less than needed in order to let Belarusians feel themselves as part of the European community of nations. Removing artificial obstacles on the way of citizens of our countries should be our aim. The EU member-states visa policy towards Belarus should be reconsidered aiming at by softening of the visa regime and reducing or even abolishing the visa costs for Belarusians. We all know that the whole region will benefit from an open

democratic European Belarus starting from Belarusian citizens, the EU as a whole and all Belarus' immediate neighbours, including the Russian Federation.

This report is written by widely known experts from the region will indubitably help to develop a better understanding of what Belarus is, in what directions it is moving and how Europe can influence the dynamics taking place within the Belarusian society and economy.

# **Economic relations between Belarus and Finland**

Seija Spiridovitsh

## **Contents**

1.	Background	26
2.	Trade relations expanding	27
3.	Foreign direct investment	29
4.	The opportunities of the free economic zones not utilised	31
5.	Agriculture and food industry	31
6.	Energy	32
7.	Information and communication technology	34
8.	Looking into future	35

## **1. Background**

Relations between Finland and Belarus were active in the 1970s and 1980s. There was fruitful co-operation in the sphere of culture, education, science and other fields. Finland was one of the leading trading partners of Belarus in the Soviet era. Despite good preconditions, Belarus and Finland failed to build bilateral relations on a solid basis in the 1990s. For the time being, the contacts are insignificant and undoubtedly far from potential. The main problem in the bilateral co-operation is in different political aspirations. Being outside from the main European organisations, Belarus is not seen as a key partner for Finland.

Following the break-up of the Soviet Union, the bilateral relations between Belarus and Finland started to be built up on a new basis. Finland recognised Belarus' independence on December 30, 1991. Diplomatic relations were established on February 26, 1992. Political dialogue was active during the first half of the 1990s. By the mid-1990s, Finland and Belarus signed agreements on trade and economic co-operation, and on the encouragement and mutual protection of investment. On the avoidance of double taxation the countries agreed to use a Finnish-Soviet agreement, which was signed on October 6, 1987.

The Belarusian-Finnish political relations suffered a serious setback in the second half of the 1990s. Finland stopped its political dialogue with Minsk. Attempts to bring the two positions closer in the end of the decade were not successful. Since the year 2000, political contacts between Finland and Belarus are through diplomatic channels only.

Nevertheless, Finland and Belarus have potential and desire to increase co-operation in several fields, e.g. economic co-operation. New interstate agreements have recently been signed and contacts between companies are increasing. For instance, the agricultural sector, bio energy and other alternative energies, forest industry starting from forest harvesting to wood processing as well as the information and communication sector offer opportunities for co-operation.

## 2. Trade relations expanding

Finland and Belarus have not been very successful in economic co-operation during the last 15 years. The share of Belarus in Finland's exports has been about 0.1% and in imports even less. However, there is a clear growing tendency both in exports and imports, as the chart below shows.

**Chart 1. Finland's trade with Belarus**



Source: Customs of Finland.

In 2005, the Finnish exports to Belarus amounted to EUR 37 million. During the first ten months of 2006, the Finnish exports to Belarus rose almost 55% compared to the same period of the previous year, amounting to EUR 46 million. The value of the Finnish imports from Belarus was EUR 22 million in 2005. During January-October 2006, the imports grew 26%, amounting to EUR 26 million. The trade balance remains favourable for Finland, and the surplus reached almost EUR 20 million at the end of October as a result of the dynamic growth of the Finnish exports during the first ten months of 2006.

Chemical products dominate Finland's exports to Belarus with a share of over 37% in January-October 2006. The growth has been noticeable in several sub-sectors, but especially in pharmaceutical products which have taken a share of over 10% in Finland's

total exports to Belarus. Industrial and electric machinery, paper and paperboard and petroleum products have traditionally occupied a substantial share in the Finnish exports to Belarus.

**Table 1. Finland's exports to Belarus in January-October 2006**

<b>SITC-code</b>	<b>EUR million</b>	<b>Share %</b>	<b>Change %</b>
<b>1</b> Pharmaceutical products	4.9	10.6	37.4
<b>2</b> General industrial machinery	4.2	9.1	63.4
<b>3</b> Petroleum and products	3.7	8.0	95.9
<b>4</b> Non-metallic mineral manufactures	3.0	6.6	80.5
<b>5</b> Paper, paperboard and articles	2.9	6.3	76.9
<b>6</b> Electric machinery and parts	2.9	6.2	- 6.1
<b>7</b> Chemical materials and products	2.8	6.0	76.8
<b>8</b> Plastics in primary forms	2.5	5.4	49.5
<b>9</b> Manufactures of metals	2.1	4.6	10.1
<b>10</b> Dyeing, tanning and colouring material	2.1	4.5	9,9
<b>Top 10 export items</b>	<b>31,1</b>	<b>67.3</b>	<b>44.9</b>
<b>Exports total</b>	<b>46.2</b>	<b>100</b>	<b>54.8</b>

Source: Customs of Finland.

Also the imports from Belarus to Finland have grown with double digits for several years, though from a very low level. In January-October 2006, iron and steel had a share of about 37% of all the Finnish imports from Belarus. Finland has traditionally been one of the leading buyers of the Belarusian wire rods and castings. During ten months of 2006, there was a substantial growth in imports of petroleum and petroleum products whose share in the Finnish imports from Belarus rose to almost 30% from under 1% a year earlier. Finland is also a significant customer for the Belarusian polyethylene and acrylic fibres.

On the other side, the imports of cork and wood, that traditionally have occupied a large share in Finland's imports from Belarus, declined about 66% in January-October 2006 compared with respective period of the previous year. This can be explained with the attempt of Belarus to restrict the exports of raw wood and to increase domestic processing. It is also worth mentioning that imports of clothing has shown tendency of diminishing for several years. Earlier the Finnish manufacturers used to subcontract their

clothes to the Belarusian textile factories. As the salary level keeps increasing, subcontracting has moved from Belarus to countries with lower manufacturing costs.

**Table 2. Finland's imports from Belarus in January-October 2006**

<b>SITC-code</b>	<b>EUR million</b>	<b>Share %</b>	<b>Change %</b>
<b>1</b> Iron and steel	9.6	36.5	- 4.6
<b>2</b> Petroleum and products	7.7	29.3	>999
<b>3</b> Manufactures of metals	1.7	6.4	21.7
<b>4</b> Hides, skins, fur skins, raw	1.4	5.5	77.8
<b>5</b> Apparel and clothing accessories	1.4	5.2	- 9.7
<b>6</b> Cork and wood	0.9	3.4	-66.1
<b>7</b> General industrial machinery	0.8	2.9	19.7
<b>8</b> Machinery for specialised industries	0.7	2.7	50.2
<b>9</b> Vegetables and fruit	0.6	2.4	>999
<b>10</b> Plastics in primary forms	0.3	1.3	-19.1
<b>Top 10 import items</b>	<b>25.2</b>	<b>95.6</b>	<b>40.1</b>
<b>Imports total</b>	<b>26.3</b>	<b>100</b>	<b>38.3</b>

Source: Customs of Finland.

### **3. Foreign direct investment**

The economic policy of Belarus has targeted to the import substitution and the development of production at domestic enterprises. This policy has largely resulted in the absence of foreign direct investment in the country. Since gaining its independence, Belarus has accumulated only EUR 190 per capita in foreign direct investment. Another indicator that shows the country's integration into the world economy is a low number of foreign corporations and affiliates. According to World Investment Report 2006, there are only three foreign corporations and 39 foreign affiliates in Belarus. Not to mention that most of the investors come from the neighbouring Russia.

Belarus is determined to continue on this path. In March 2006, the Government of Belarus adopted the state import substitution programme for 2006-10. The programme aims to ensure a sustainable economic growth and to satisfy the domestic demand with the Belarusian goods. To reach these goals, however, Belarus is expected to enhance the

technical level of the production facilities which could create opportunities also for foreign suppliers.

*The Finnish investments almost non-existent:* Due to the unfavourable political and economic climate and state interference to the business, the Finnish investments in Belarus are virtually non-existent. According to the Belarusian Ministry of Economy, the country has nine companies involving Finnish capital, totalling some EUR 390,000. However, Finland and Belarus have potential and desire to increase investments. A new Belarusian-Finnish interstate agreement on the mutual promotion and protection of investments was signed in Minsk in June 2006, and the ratification bill was approved by the National Assembly's House of Representatives of Belarus in October 2006. The legislative basis will be complemented in the near future with the assignment of a new agreement on the avoidance of the double taxation.

The new investment agreement is expected to contribute to more effective development of the co-operation between the two countries. Among other things it allows investors to choose whether or not to enjoy tax concessions. Without doubt the new accord creates more favourable conditions for investors and provides for a better investment protection. The parties of the agreement undertake to facilitate mutual investments in accordance with national legislations, ensure fair conditions for investors and protect investments. Besides, the document provides with two investment modes: most favourable treatment and national treatment.

The preconditions for investments do exist. The Belarusian authorities have been interested in the Finnish experience and know-how for instance in the utilisation of bio energy and other alternative energy sources. Belarus welcomes also high technologies, including nanotechnologies, woodworking and the processing of agricultural products. The price hikes in energy prices for Belarus at the beginning of 2007 create opportunities for Finnish experience in energy saving.



#### **4. The opportunities of the free economic zones not utilised**

One should pay attention to the opportunities that the free economic zones (FEZs) offer for investors. There are six free economic zones in Belarus, one in each region: Gomel, Minsk, Vitebsk, Brest, Mogilev, and Grodno. The FEZs offer a favourable environment for profitable investment, which is guaranteed by the state laws. The FEZ residents enjoy a privileged tax regime as well as customs and other advantages. For instance, the profit tax is half of the common republican rate (for FEZ in Mogilev and Grodno 12%, for other FEZs 15%). In addition, the FEZ residents only pay a limited number of other taxes and non-tax payments, e.g. profit and income tax, value-added tax, excise taxes, environmental tax, personal income tax, land tax (or rent), state and social insurance contributions, state duties and fees etc.

President Lukashenka has called for the establishment of the joint import-substituting production of consumer goods with foreign producers. The country suffers from substantial trade deficits and should produce more competitive products for export markets. To reach this goal, it needs foreign technology and know-how. In the coming years, the export revenues will be needed also to cover the rising energy bills.

In the following, we would like to highlight a few sectors which could offer opportunities for co-operation between the Finnish and the Belarusian companies.

#### **5. Agriculture and food industry**

Agriculture plays an important role in Belarus' economy and produced over 10% of the GDP in 2006. Until now the large Russian market has guaranteed demand for the Belarusian agricultural and food products. Recently, Russia has threatened to impose sanctions against the Belarusian foodstuffs. It will accept meat, milk and fish only from enterprises certified by Russia's Federal Service for Veterinarian and Vegetation Sanitary Supervision (Rosselkhoznadzor). Analysts also presume that Russia will soon begin imposing duties on the Belarusian goods.

Finland has a wide knowledge of the foodstuffs industry. It also has long experience in co-operation with the Russian certification authorities in the field of agricultural and food products. Many Finnish companies have operated in the EU accession countries that have been pushed to change their production processes in compliance with EU standards. The entire foodstuffs chain in Finland is committed to high quality of food, from the field to the fork. This large-scale experience could be utilised in Belarus to meet requirements in different countries and to enhance exports.

*Demand for agricultural technology:* There are opportunities for deeper co-operation also in the field of the agricultural machinery. Recently, the Belarusian Bobruiskagromash farming machinery maker concluded a contract to deliver mowers and fertiliser applicators to Finland. Bobruiskagromash has been selling its machinery to Finland for over three years already. Also the well-known Minsk Tractor Works (MTZ) succeeded in 2006 for the first time to supply its tractors to Finland.

Encouraging for the Finnish manufacturers of the agricultural technology are the plans of the Ministry of Agriculture of Belarus to invest some EUR 1.5 billion in the agriculture and food processing in 2007, a 37%-increase compared to 2006. The money will be used primarily in the reconstruction and modernisation of milk and cattle farms, as well as in the modernisation of the agricultural machinery and tractors. In the coming years, animal husbandry will take a leading position in the Belarusian agriculture. According to the development plan for the period 2006-2010, the country will reconstruct some 1370 milk cow farms, 100 cattle farms and over 100 pig houses. As regards to the agricultural machinery and tractors, the farms are entitled to import also foreign high technology, especially if comparable technology is not available at the domestic market.

## **6. Energy**

The next three to four years will be difficult for Belarus following the drastic increase in energy prices from Russia. Earlier Belarus has relied heavily on cheap Russian natural gas and oil to fuel the largely Soviet-style, centrally controlled economy. In coming years, it has to pay more than twice the previous price for the Russian gas. In addition, the Russian

crude supplied to the Belarusian refineries (20 million tonnes in 2007) is now subject to an export duty of EUR 41 a tonne. The duty on petroleum products made from this oil and then exported from Belarus (14 million tonnes this year) is now equal to the Russian duty, and 70% of the revenues will go to Russia. The outcome of a subsequent dispute over oil supplies and transit fees will reduce the profits Belarus has made by refining the Russian oil, and thereafter selling the products abroad.

*Alternative energy sources sought:* To reduce its dependence on the Russian oil and gas, Belarus is seeking ways to cut energy consumption and to develop alternative sources of supply. After strictly opposing nuclear power earlier, Belarus has now started to study prospects of constructing a plant in the country. Finland is also accelerating work in this area and has gathered experience in its earlier projects. The Finnish know-how, e.g. in issues of safety, security and waste fuel disposal of nuclear power plants, might offer opportunity for co-operation with the Belarusian constructors of the new plant.

The modernisation of the existing power plants is also an area where the Finnish companies have large experience to share. In order to increase the efficiency of energy consumption, Belarus needs new technologies for its power generating facilities, most of which were built back in the 1960-1970s. Belarus uses 370 grams of fuel to produce 1 kilowatt-hours (kWh) of electric power, whereas modernised facilities use only 305 grams. There are plans to build combined-cycle plants that use 160 grams of fuel to produce 1 kWh of power. The Belarusian Government has adopted a draft state programme of energy saving for 2006-10 that requires investments worth EUR 4.1 billion, of which EUR 2.1 billion will be spent on upgrade of energy-generating facilities.

*Wood waste as energy source to be increased:* Interesting field for co-operation between the two countries could be the utilisation of wood waste as energy source. There is a lot of forest in Belarus especially in the northern and north-eastern parts of the country, and a large amount of wood waste that cannot be utilised due to lack of appropriate technology. The Lithuanian Axis Industries has already launched production of wood waste granules in the Gomel region and exports the Belarus-made granules, e.g. to Finland.

There is a tendency to increase the utilisation of wood waste as an energy source. According to the government program on the modernisation and development of the energy sector up to 2010, the share of local energy sources is to be doubled from current 12% to 25%. To achieve the goal, a special attention will be paid to wood waste. There are plans to construct mini thermal power stations where the wood waste is the primary energy source.

One potential source for energy production is peat that is considered also in Belarus as an alternative energy source. The state fuel and gas distribution company Beltopgaz is considering the possibility of building a plant that would manufacture lump peat. Representatives of Beltopgaz have visited peat-processing plants in Finland and hold negotiations for purchasing the necessary equipment. The plant is to be located in the Vitebsk region to satisfy the needs of the local power plant.

According to the government's fuel industry development programme for 2006-2010, peat production is to be increased to 3.3 million tonnes a year. The explored peat reserves in Belarus total almost 80 million tonnes, which are enough for at least 25 years.

## **7. Information and communication technology**

Belarus has one of the least developed telecommunication markets in Europe. At the beginning of 2006, the penetration rate in the mobile market was only 42%. However, the growth is picking up, and by the end of 2006, the penetration is estimated to have reached 60%. With the penetration now over 100% in neighbouring Russia and over 90% in Ukraine and Poland, foreign investors have begun to pay more attention to the fast developing Belarusian market.

The telecommunication sector in Belarus is one of the few sectors that have succeeded in attracting foreign investments. Although all telecommunication companies are still majority-owned by domestic operators, foreign shareholders have invested heavily in their operations in the country. The Russian joint owner of the leading mobile operator on the market MTS has invested several millions euros in the development of its activities in

Belarus. Also the second largest player MDS, co-owned by the Cyprus-based SB telecom, is planning to invest substantial sums on its network modernisation and expansion. MDS is already testing 3G network in Minsk, whereas MTS is waiting for a commercial 3G licence from the Ministry of IT and Communications.

In order to develop the ICT sector in Belarus, president Lukashenka initiated in 2006 a plan of High Technology Park (HTP) in Minsk. The main objective of the park is to foster development of the Belarusian IT companies and help them to find foreign partners as well as to raise awareness of them in foreign markets. There are long traditions in Belarus in this field, as in the Soviet era the country specialised in electronics and telecommunication industry. Some Belarusian companies have already world famous companies, such as Coca-Cola and Colgate-Palmolive in their clientele.

The first stage of the project is now implemented, and the administration of the HTP plans a large-scale campaign to promote its opportunities among potential investors abroad. According to the administration of the park, several foreign companies, such as the Finnish-Swedish TietoEnator, have expressed willingness to become residents of the park. In addition, SAP and Microsoft are in the process of obtaining state registration in order to open their representative offices in Minsk. The resident companies of the HTP have highly-qualified labour force whose expertise could be valuable, for instance in subcontracting.

## **8. Looking into the future**

There are several sectors where the Finnish and the Belarusian companies could find mutual interest and the basis for good co-operation. However, the deepening of the co-operation requires a more active dialog between the partners and increased knowledge on each others competences.

The trade turnover between the two countries is still small and investments almost non-existent. Both sides should consider possible variants of bilateral co-operation and draw up concrete projects and programmes. Belarus, certainly, provides good investment

opportunities for the Finnish companies in several sectors. As to our knowledge, there is interest also on the Belarusian side for investments in Finland.

Before putting money into large projects, the partners need to get necessary investment guarantees. The key legislation is in place, but not always duly followed. Profitable business requires also lightening of the hard taxation burden, the simplification of excessive regulation, and the reduction of bureaucracy that still complicate business activity in Belarus.

Western companies confront in Belarus also some other important challenges. A major one is the country's political image. The authoritarian rule has led the country to a sort of political isolation from Western Europe, and open dialog with western counterparts is missing. However, the business environment of Belarus is bound to change. Many of its close neighbours have joined the EU and are adapting western rules for their business operations. The rising cost of energy inputs in 2007 and over the following years highlights the vast needs to restructure the Belarusian economy and to increase exchange of knowledge and experience with neighbours. Thus, it can be hoped that the changes in the operational environment will prove a catalyst for Belarus for embarking on a reform bath and opening up for deeper co-operation with its western partners, Finland among them.

## **Latvia and Belarus: Economic relations <sup>1</sup>**

### **Contents**

1.	Background	38
2.	Trade	39
3.	Transit	42
4.	Investment	42
5.	Business environment in Belarus	45
6.	Conclusion	46

---

<sup>1</sup> The article was prepared with the assistance of the Embassy of Latvia in Belarus.

## **1. Background**

Latvia and Belarus have always professed the importance of economic partnership and have maintained close economic relations. The entry of Latvia into the European Union in 2004 gave a boost to the economic co-operation of the two countries. The following factors have favourably influenced the dynamics of Latvian-Belarusian economic relations:

- the countries are neighbours with a common land border;
- ethnic Belarusians form the second largest minority group in Latvia;
- certain private contacts and contacts between business people have been preserved since earlier times;
- Latvia sees the potential of the 10 million strong Belarusian market for her goods;
- Belarus has interest to sell her goods not only in Latvia, but through Latvia-registered enterprises also in the rest of the European Union;
- Latvian trademarks such as Lauma, Latvijas Balzāms, etc. are well known in Belarus;
- despite considerable risks, Belarus is still attractive to Latvian businessmen because of her comparatively cheap labour and raw materials.

On the other hand, since exports make up a large part of Belarus' budget, she is interested in the ports of Latvia (Ventspils, Rīga, Liepāja) for the transit of her produce, chiefly oil, oil products and potassium salt. When Latvia joined the European Union, bilateral economic relations did not decrease as some had feared, but increased rather impressively (see below the Latvian-Belarusian foreign trade dynamics in 1998 – 2005). Belarusian entrepreneurs became more motivated to set up joint enterprises in order to be able to sell their produce in the EU market.

A proof of mutual interest to maintain and develop economic ties is the Intergovernmental Commission, co-chaired by the Minister of Economy of Belarus and the Secretary of State of the Ministry of Economy of Latvia. The Commission meets once a year and discusses issues of bilateral economic co-operation. For example, the latest Commission in October 2006 discussed co-operation in the spheres of transport, research and development, certification, health care and others. An agreement on co-operation in emergency situations and a protocol on co-operation in fostering mutual tourism were signed. The overall Agreement on the Economic, Scientific and Technical co-operation between the



Government of Latvia and the Government of Belarus was signed on April 21, 2004\*. It is the paramount 'umbrella' agreement which regulates bilateral economic co-operation in industry, tourism, transport, pharmaceutical production, agriculture (agricultural production included), banking, insurance and other financial services, communications, professional training, investment policy, research and development and other fields, as well as transborder co-operation.

Parallel to the meetings of the Commission, the Belarusian side organises a Business Forum attended by businessmen from both countries, who have either launched their activities in the neighbouring country or are about to do so. During the latest Forum, for example, the participants both exchanged opinions on general issues – such as the problems of privatisation and business environment in Belarus – and organised meetings with potential co-operation partners.

A detailed overview of the most important aspects of bilateral co-operation follows.

## 2. Trade

For Latvia Belarus is an important trade partner. Trade volume since 1998 has grown six-fold (see Table 1).

**Table 1. Latvian-Belarusian trade in 1998-2005 (USD million)**

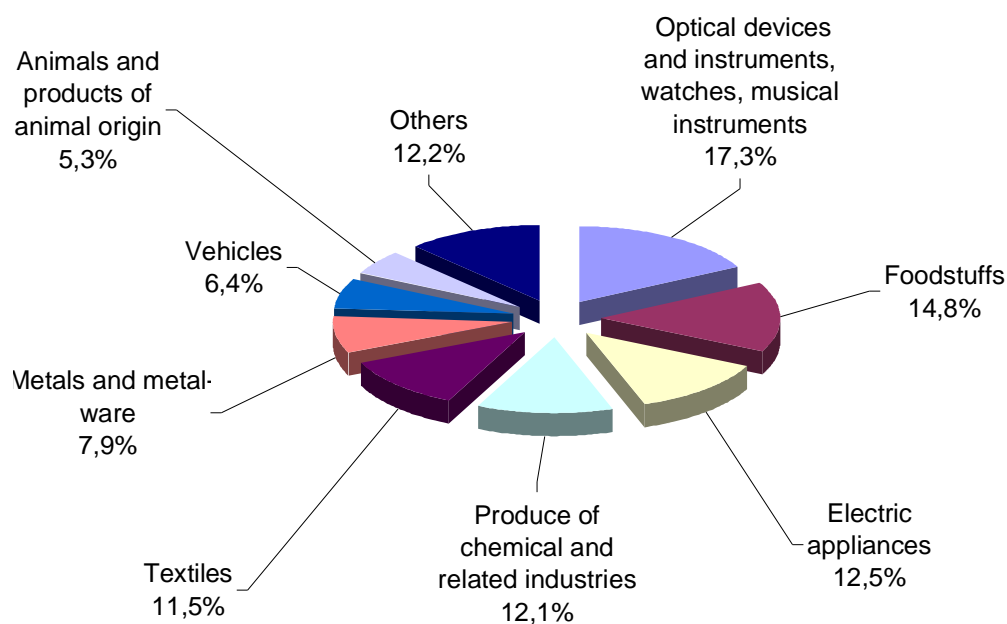
	<b>Exports</b>	<b>Position</b>	<b>Imports</b>	<b>Position</b>
<b>1998</b>	35.6	12	54.5	16
<b>1999</b>	29.8	14	84.3	13
<b>2000</b>	22.5	17	109.5	11
<b>2001</b>	35.8	14	135.7	9
<b>2002</b>	34.2	16	110.6	11
<b>2003</b>	42.1	16	194.5	9
<b>2004</b>	83.6	14	336.1	8
<b>2005</b>	101.4	14	498.5	7

---

\* Bilateral co-operation agreement between Latvia and Belarus was signed in 1994. Taking into account the entry of Latvia into the European Union, a new agreement was signed on April 21, 2004. Latvia and Belarus have signed agreements on investment protection and on avoiding double taxation, as well as a number of agreements have been signed on the level of ministries.

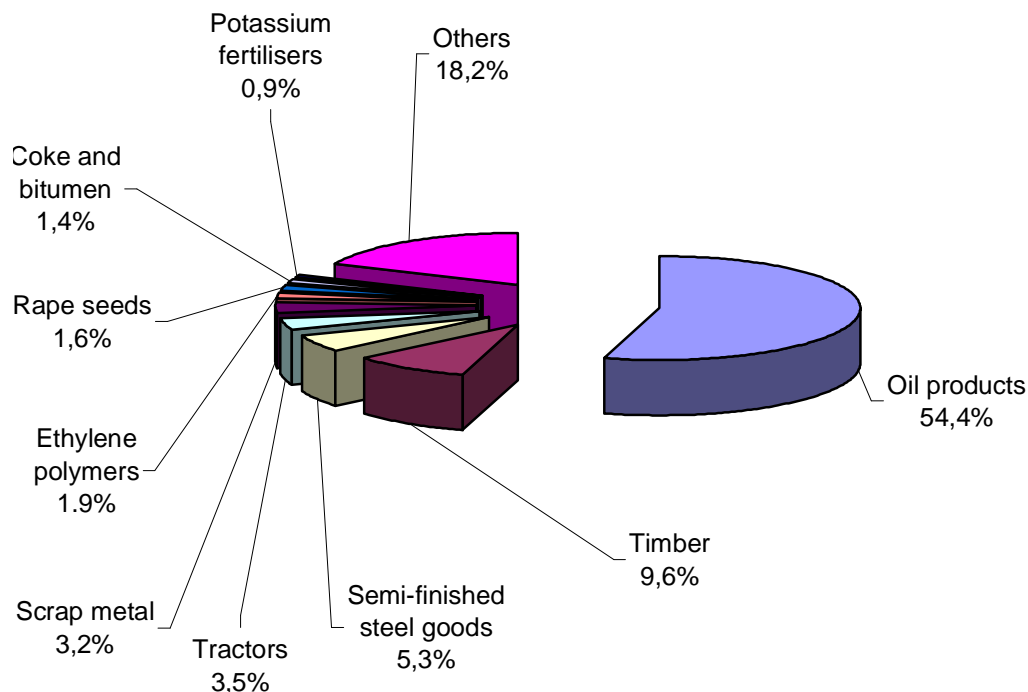
In 2005, Belarus ranked 14<sup>th</sup> among Latvia's export partners and 7<sup>th</sup> with regard to her imports. Latvian exports to Belarus are varied (see Chart 1).

**Chart 1. Main groups of goods that Latvia exports to Belarus (%)**



Latvia imports from Belarus mainly mineral products, timber and wooden products, metal-ware, and tractors. In accordance with data provided by the Ministry of Economy of Belarus, the trade volume with Latvia ranks 9<sup>th</sup> among countries which are not members of the Commonwealth of Independent States. Latvia ranks 7<sup>th</sup> among export and 14<sup>th</sup> among import partners of Belarus.

**Chart 2. Main groups of goods that Latvia imports from Belarus (%)**



In recent years Belarus has started to promote her export potential more actively. In December 2006 in Riga, Belarus organised Belarus Expo – an exhibition of Belarusian goods. The role of Belarus in the external trade turnover can well be estimated by the following figures which show the specific weight of Belarus among other trade partners of Latvia.

**Table 2. External trade of Latvia in 2005 (USD million)**

***Exports***

1.	Lithuania	– 562.5 or 11.00%
2.	Estonia	– 552.8 or 10.81%
3.	Germany	– 523.7 or 10.25%
4.	Great Britain	– 516.2 or 10.10%
5.	Russia	– 404.1 or 7.91%
...		
<b>14.</b>	<b>Belarus</b>	<b>– 101.4 or 2.00%</b>

***Imports***

1.	Germany	– 1201.8 or 13.95%
2.	Lithuania	– 1177.8 or 13.67%
3.	Russia	– 732.4 or 8.50%
4.	Estonia	– 678.4 or 7.88%
5.	Poland	– 548.5 or 6.37%
...		
<b>7.</b>	<b>Belarus</b>	<b>– 498.5 or 5.78%</b>

### **3. Transit**

Transit plays an important role in the mutual economic relations of Latvia and Belarus and is one of the most important issues of the co-operation between the two countries. In 1999, they signed an intergovernmental agreement on conditions under which flows of Belarus transit goods can make use of ports and other transport infrastructure of Latvia. The latter has great interest in creating favourable conditions and foster the transit of Belarusian goods through her ports.

After Russia, Belarus is the second largest transit partner of Latvia, transporting mainly potassium salt and oil products through the Latvian ports of Ventspils, Riga and Liepāja. Belarusian transit adds up to 35% of all cargoes transported by rail in Latvia and to 25% of all cargo turnover in Latvian ports.

The Free Port of Ventspils: Ventspils is an ice-free port with capacity to serve ships of up to 150,000 tonnes. It specialises in the transit of oil, oil products, mineral fertilisers and coal. Majority of potassium salt from Belarus is being transported via the port of Ventspils. Potassium salt terminal was initially built in the Soviet period just for exports from Belarus; in the 1990s it underwent impressive reconstruction and adjustment to the contemporary environmental standards and now stands among the largest in the world. It handles up to 3.5 million tonnes of salt from Belarus annually.

Since Latvia borders on Russia (most of the transit goes between the EU and Russia), the road transit via Belarus is not that essential to Latvia as it is, for example, to Lithuania and Poland. Latvia would be interested to increase the flow of cargoes through Belarus to Ukraine, however because of over-complicated customs procedures and risks of truck load confiscation, most haulers choose to bypass Belarus via Poland.

### **4. Investment**

During the last four years Latvian investment in Belarus has increased almost 20 times. At the end of 2005, the total Latvian investment in the neighbouring country was USD 129

million (ranking 5<sup>th</sup> after Russia, Switzerland, Austria and Germany). Latvia has invested slightly over 10% of all the direct investment into the equity capital of foreign enterprises registered in Belarus.

The largest Latvian investment in Belarus is in the business of wood-processing, trade, information technologies as well as in banking. However, on the whole Latvian investors act with caution – because the investment climate and business environment in Belarus is not favourable, in particular with regard to foreign investors. The legislation is being changed almost constantly; the state intervenes in the price-formation and often in the actual operation of businesses; in general the government control of private business is excessive.

Currently 176 joint ventures with Latvian shareholders have been registered in Belarus. Some of these enterprises, though, have suspended their activities and are waiting for the positive changes in the business environment in that country.

Recently the largest investment in Belarus has been made by the owners of the Latvian textile manufacturer Lauma, which in mid-2006 obtained approximately 13% of shares in the leading Belarusian lingerie manufacturer Milavitsa for about USD 3 million. In four to five years the enterprise has to invest EUR 15-20 million, setting up a network of 300-400 retail shops in which 60% of goods would be produced by Milavitsa. In the future analogous retail networks are planned to be set up in Ukraine, Kazakhstan and the Baltic States.

According to the data of the National Bank of Belarus, four out of eleven registered branch offices of foreign banks are Latvian – Rietumu banka, Trasta komercbanka, Lateko banka and Aizkraukles banka. Very active in Belarus is also Parex Asset Management – a subsidiary of the Latvian Parex Bank – which works in three directions: consulting and placement of funds into individual investment portfolios, investment funds and accumulation funds. Parex Leasing is another subsidiary of Parex Bank, which engages in the leasing of vehicles – from passenger cars to specialised vehicles.

Although the number of Latvian enterprises in the wood-processing business has shrunk, some have remained in Belarus – with Shklov Forest Ltd (a subsidiary of a Latvian Lindex) and IT grupa largest among them.

Belarus is a traditional market for fish caught in Latvia. Latvian enterprises N-stars, Kolumbija, Baņķis a.o. supply frozen and canned fish to Belarusian consumers.

In the course of time good co-operation has been established between the port enterprises in Latvia and Belarusian producers. For example, a Liepāja port enterprise Liepājas osta LM handles bulk freights (peat and wood briquettes) and metal (Liepājas osta LM cooperates with the Belarusian Metal Works). Belarusian oil and oil product transit via the port of Riga is being handled by the port enterprise Man-Tess.

The Latvian air carrier airBaltic intends to expand its operation in Belarus and, in addition to Minsk, in March 2007 will launch another destination – Gomel. To its Belarusian customers, airBaltic offers not only direct flights to Riga, but convenient connections to an ever increasing number of destinations in Europe.

In January 2007, there were 306 joint ventures with Belarusian capital registered in Latvia, which has developed into an attractive environment for Belarusian businesses (15% corporate income tax, Latvia-registered enterprises may compete for EU funds, etc.). Belarusian investment mainly goes to retail trade, real estate, legal services, accountancy, bookkeeping and auditing. Latvia-registered firms sell the produce of the Minsk Tractor Works, as well as fridges, construction materials, footwear, perfumes and other goods. During the last two years Belarus has set up in Latvia representations of Belneftekhim (oil and chemical products) and Belgospistcheprom (food production) holding companies, as well as of the unitary company Belexport; they are instrumental in expanding the exports of Belarusian oil, food and wood industry production.

Although the latest notable increase in the price of energy carriers will raise the price of Belarusian construction materials by about 25%, the scope and tempos of construction in Latvia will provide a stable demand for this produce. The largest retail trader for Belarusian construction materials in Latvia is the limited liability company Iļģuciems.

## **5. Business environment in Belarus**

Although Latvian businessmen admit their interest in Belarus, they are reluctant to risk any considerable investment because they consider the business environment unfriendly. Following is a summary of observations and complaints to exemplify and explain the above mentioned.

*Interference of the state in the price-formation:* A study of the World Bank has shown that 60% of the surveyed enterprises admitted that the state with the help of relevant regulations interferes in the price policy of enterprises and thus dictates the prices in the market. The state controls the prices in services, wholesale and retail trade, as well as in industrial enterprises.

*A lengthy and resource-consuming process of the registration of businesses:* Registration of enterprises in Belarus is a time- and resource-consuming process involving a host of government institutions. The process of registration may take from 26 to 40 days.

*State control in private enterprises:* In Belarus enterprises are being subjected to frequent and lengthy inspections performed by various control agencies. In 2005, a Belarusian enterprise had to receive an average of seven to ten inspections with a total length of 70 days. The larger is the enterprise the more frequent and lengthier are the inspections.

If any violations are established, fines are applied which the majority of businessmen consider inadequate. The businessmen also claim that the application of fines lacks transparency and often even legal grounds.

*Sporadic changes of legislation:* Foreign investors complain about constant and unpredictable changes in legislation directly pertaining to entrepreneurial activity.

*Attitude towards foreign investment:* As of January 1, 2006, enterprises with foreign capital can no longer enjoy a number of previously established tax holidays – mainly those previously established for the import of equipment which constituted a part of the equity

capital. Currently such tax holidays in each individual case can be established only by a Presidential decree.

## **6. Conclusion**

History and geography has determined that Latvia and Belarus have important economic ties. The tendency of the recent years shows that economic co-operation is being expanded in all spheres. Latvia's entry into the European Union gave a boost to bilateral economic relations, not in the least because of the fact that it provided Belarus with an additional opportunity to participate in the European market with 457 million people. Latvian businesses have preserved interest in Belarus because of her comparatively lower labour and raw material costs.

The main obstacle to a more intensive economic co-operation between the two countries is the specific economic model of Belarus – command-administrative, planned economy with a strong state control of the private sector.

The current political thinking in Belarus prevents her from reforming and reverting to free market economy, hence also to creating of new businesses. Lately a reverse tendency is being observed – a decrease in the number of private businesses.

At present, it is difficult to foresee how detrimental the increase in the gas and oil prices will be to Belarusian economy. Liberalisation could be a solution; however, an even larger pressure on businesses because of budget requirements cannot be excluded.



## **Latvia-Belarus economic relations**

Raita Karnite

### **Contents**

1.	Introduction	48
2.	Economic reasonability of co-operation	48
3.	Political background	52
4.	Trade between Latvia and Belarus	54
5.	Investment	56
6.	Tourism between Latvia and Belarus	59
7.	Other co-operation	61
8.	Future prospects	61
	Appendix	63

## **1. Introduction**

Latvia has a 161 km-long border to the southeast with Belarus<sup>1</sup>, common border crossings and a common history. But today the differences are great. Latvia is an independent country, but one whose actions are influenced by being a member state of the European Union. A democratic state structure has taken root in Latvia. Economic growth is rapid, but the structure of the economy has changed significantly. Latvia has moved from being an industrial country at the end of the 1990s, when industry comprised 35% of GDP, to being a service economy. In the second half of 2006, the share of the service sector in GDP was almost 75%<sup>2</sup>.

Belarus is also an independent country, a member of the CIS with an unusual political structure. The international community has criticised Belarus for its political structure and infringements of democracy. However, its close co-operation with Russia has produced rapid economic growth, helped to preserve industry, and therefore, laid a firm foundation for economic development. Being a large country is an advantage in the globalised world which Belarus has managed to exploit.

## **2. Economic reasonability of co-operation**

The basis of economic co-operation is interests, and therefore these should be sought out first. Both countries have a common development goal – improving the quality of life of their population. True (socially-grounded) economic interests are subordinate to this goal.

Latvia's interests in Belarus are easy to ascertain. Latvia is a small country and the scale of its economic activity is limited by the market. In December 2006, Latvia had a population of 2.3 million<sup>3</sup>. The population is rapidly decreasing due to a low birth rate and emigration. Although official statistics continue to show heartening long-term migration – from January to September 2006 only 204 more people left the country than arrived and

---

<sup>1</sup> Statistical Yearbook of Latvia, Central Statistical Bureau of Latvia, Riga, 2006, p. 7.

<sup>2</sup> Monthly Bulletin of Latvian Statistics, 2006, 11 (150), Central Statistical Bureau of Latvia, Riga, December 2006, p. 29.

<sup>3</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, January 2007, p. 8.

the number of one-way migrants to foreign countries is just 613 people<sup>4</sup> – the actual number of people who have left is much larger<sup>5</sup>.

Latvia's market is small, and its capacity is even smaller considering the income level<sup>6</sup>. There are only 7 million people in the combined Baltic market<sup>7</sup>, and its market capacity is as unclear as in Latvia. The limited nature of the domestic and regional market is one of the reasons why Latvia is interested in co-operating with Belarus. Belarus has a population of 10.3 million. The market capacity is limited by low income levels, but they are rising. Since 2001, Belarus' annual GDP growth rate has been between 5-11%<sup>8</sup>.

The second reason is also connected with the small number of inhabitants. Due to rather low birth rates and emigration, Latvia's population is falling by 1-2% annually.<sup>9</sup> Although unemployment indicators are quite high (in the III quarter of 2006, only 6.2% of economically active population were seeking work), the economy is also experiencing a labour shortage. As a result, the wages are rising – for the first three quarters of 2006 real salaries grew by 11.3%, 14.5% and 15.4% respectively compared with the same quarter of the previous year. In fact, Labour costs have grown by 10-25% every quarter since 2004.<sup>10</sup> Guest workers from Belarus who are usually good specialists could be a positive addition to Latvia's shrinking labour market.

The third reason for co-operation is supply of energy. Latvia's experience shows that reliance on one supplier can be costly. Fuel price has increased in Latvia during several periods in 2004, and the increases were among the highest in the European Union, chiefly

---

<sup>4</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, January 2007, p. 37.

<sup>5</sup> Source: unofficial information in the press originating from the Latvian Ministry of Economy and other state bodies and the results of sociological studies.

<sup>6</sup> The number of inhabitants is precisely known but the living standard of the population can only be estimated. According to official personal income indicators, it is one of the lowest of all European Union member states, but market price information and the frequency of expensive purchases indicate that at least a part of the population is rather well off.

<sup>7</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, January 2007, p. 111.

<sup>8</sup> Country Report June 2006, The Economist Intelligence Unit Limited, 2006.

<sup>9</sup> Statistical Yearbook of Latvia, 2006, Central Statistical Bureau of Latvia, Riga, 2006, p. 44.

<sup>10</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, January 2007, pp. 40, 12, 44.

because of the pricing policies of the main supplier, the Mazeikiu oil refinery. Out of this bitter experience, Latvia has started sourcing fuel from Belarus.

The fourth reason for co-operation is the strengthening of Latvia's economic structure by developing its industry. In the third quarter of 2006, the share of industry in Latvia's GDP was just 12%<sup>11</sup>. But thanks to its open economy, the global financial sector has moved into Latvia. As a result, the financial movement and deployment sectors including banks, financial institutions and spheres connected with financial transactions (real estate, retailing, construction) have become dominant, holding a combined share of GDP of 47%, and growth rates in each sector (excluding the finance industry) exceed 15% annually<sup>12</sup>. This has led to an unstable foundation for Latvia's economy which must be corrected. The experience of Belarus in developing its industry and investment could be valuable.

Finally, Latvian entrepreneurs with cheap finance from global markets want to invest as efficiently as possible. For holders of free financial resources, Belarus is attractive due to the fact that its production costs seem lower, while after the EU accession the costs are increasing rapidly in Latvia. Compared with the previous year, producer prices grew in 2004 by 9%, in 2005 by 8%, while in 2006 by 10%<sup>13</sup>. The rises in producer prices are caused by rising resource and labour costs.

It is more difficult to see what Belarus' interests are in economic co-operation with Latvia. For example, there is no justification for Belarus to be interested in investing in the Latvian industry because there are better development opportunities in their own country (state support, cheap subsidised energy, other resources, an unlimited market – in both Belarus and Russia – and cheap labour). With regard to investments in the service sector, Belarusian enterprises would be uncompetitive compared with Western service giants.

It is possible that Belarus is interested in Latvia's economy because Latvia is a member of the EU. Based on the principle that the EU's common foreign policy is not binding on

---

<sup>11</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, January 2007, p. 29.

<sup>12</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, January 2007, pp. 28-29.

<sup>13</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, January 2007, p. 14.

member states, Latvia is trying not to destroy economic ties with Belarus. By operating in Latvia, Belarusian entrepreneurs gain access to the EU market. Co-operation has led to enterprises being established in Latvia which adapt Belarusian goods to make them suitable for Western markets. However, other EU member states whose market, investment and development conditions are even better than those of Latvia are also interested in co-operating with Belarus.

Co-operation is facilitated by the fact that professional contacts and mutual trust between Latvia and Belarus still exist, and there are specialists in the spheres most suitable for co-operation, such as machinery building, electronics, and construction. But with the passage of time, there are fewer such specialists available.

A third facilitating politico-economic factor could be Latvia's democratic state structure and freer business environment. However, the miniscule scale of co-operation indicates that these conditions are not especially important.

Latvia's desire to employ qualified specialists from Belarus may not gain support either, because no country is interested in losing population. Inhabitants of Belarus may want to work in Latvia where income levels are higher and there are opportunities to travel to other EU member states. But these wishes find resistance on both sides: in Latvia due to a strict immigration policy and mistrust toward people from other former Soviet republics, and in Belarus due to pronounced protectionist policies.

Economic relations are definitely limited by the fact that in contrast to true market economies, the interests of the private sector are not paramount in Belarus. In parallel to true economic interests, there are always individual interests. Paradoxically, the possibility for their realisation depends on the condition of democracy in the countries involved. Stronger the democracy, the easier it is to realise an individual's interests, regardless of whether they are advantageous or not to society. In dictatorships, the clique which holds power also controls the realisation of individual interests.

Perhaps due to this authoritarianism, Belarus is not one of the countries suspected of carrying out corruption or illegal activities in Latvia. Belarusian business activities in Latvia are seen as being practical and honest.

Unfortunately, Latvia is also affected by the Belarusian response to the EU stance toward it. However, it is sometimes difficult to determine when Belarusian restrictions against the EU countries are politically motivated and when they have economic (protectionist) grounds. Taking into account all of these factors, Belarus can be considered a partially satisfactory economic partner.

### **3. Political background**

Economic expediency is the basis for people's rational actions. However, political considerations sometimes make rational action irrational.

The European public knows that the political structure of Belarus is less than democratic and should therefore be transformed. The EU's official position is to co-operate with Belarus to promote democracy, stability and economic development there. The EU has restricted economic co-operation with Belarus. Belarus is considered as a conditionally part of the European Neighbourhood Policy. It is the only Eastern European country with which the EU has not concluded a co-operation and partnership agreement<sup>14</sup>. Aid programmes are being developed in EU states for social transition programmes in Belarus, which the Belarusian Government views as attempts to destabilise the country in order to promote change towards pro-Western regime.

On the other hand, the political position of Belarus is strengthened by the fact that it is a transit country for Russian energy to EU states. Latvia does not have any political disagreements with Belarus except for a few pseudo-conflicts whose causes are quite foggy (for example in 2006, an incident involving a Latvian diplomat – the public has not been informed about the reasons either in Belarus or Latvia). The border issues are clear.

---

<sup>14</sup> The agreement between Belarus and the EU was signed in 1996 but its ratification was frozen due to the lack of respect for democracy and human rights in Belarus.

The countries have no mutual political accusations against each other, except perhaps for the bitterness amongst the inhabitants of Belarus over the lost superpower, the USSR.

However, the European Community has decided Belarus is not a good partner, and the member states must comply with this. An analyst with knowledge of the situation may ask why this is so, if a country has good economic indicators, its economic system is stable, its political and economic independence is assured and its people do not protest against the existing order. Especially given that while democracy may be a good tool for improving the quality of life in developed countries, it may actually harm the development of society in newly democratic states. This is due to the fact that the quality of knowledge, traditions and performance creates a marked asymmetry in freedom of action between developed countries and new democracies – unprecedented opportunities for developed countries and a vacuum of freedom of action in new democracies. This tendency in the early stages of democracy was very apparent in the countries of Central and Eastern Europe, including Latvia, where corruption flourished amidst state theft and economic regression.

No matter what the answer might be regarding the need to 'improve democracy' in Belarus, Latvia's economic relations with Belarus are slightly restricted by these political considerations. However, these relations are not passive. From Latvia's side, the initiators of co-operation are the Ministry of Foreign Affairs and the Ministry of Economics, utilising their own funds and those of EU support programmes. The basis for co-operation is the intergovernmental agreement between Latvia and Belarus on economic and scientific technical co-operation signed on April 21, 2004. The Latvia-Belarus intergovernmental commission was founded and operates in accordance with this agreement.

In 2004, the Ministry of Economics of the Republic of Belarus in conjunction with the Embassy of Belarus in Latvia prepared a list of investment offers and the most important investment projects for 2004. Belarus invited Latvian enterprises to invest in all sectors of the economy, from electricity to utilities provision.

The first meeting of the Latvia-Belarus intergovernmental commission was held in November 2005. It declared that there are three areas of interest for co-operation between Latvia and Belarus – transit, trade and joint investment projects. A Latvia-Belarus

investment forum was held simultaneously with the commission meeting, in which 51 Belarusian enterprises took part.

At the end of 2006, two other important events for strengthening Latvian-Belarusian relations took place in Minsk – the Belarus-Latvia Finance and Investment Forum and a meeting of the Latvia-Belarus intergovernmental commission. Statistics show that the government's work has brought results, since economic co-operation between Latvia and Belarus is growing.

Latvia has declared that its relations with Belarus will be based on the principle of good neighbourly relations, developing advantageous economic links and co-operating on normalising the ecological situation, but co-operation may be hampered by complex economic and political processes within Belarus. In addition to economic co-operation, Latvia is planning to increase co-operation in fighting organised crime, smuggling and distribution of drugs and weapons, and resolving issues relating to refugees, ecology and other problems. There are also plans to develop links with the Latvian Diaspora in Belarus.<sup>15</sup>

Political co-operation between the two countries could be hampered by periodic EU sanctions, for example, visa restrictions for travel to Belarus. Although these restrictions only affect persons close to the regime, tensions between the EU and Belarus deter companies from making long-term plans in Belarus, and vice versa.

#### **4. Trade between Latvia and Belarus**

What has been gained from this mingling of political and economic factors?

The scale of Latvia's external trade with Belarus is small, but it is expanding year on year (see Appendix: Figure 1). From 1995 to 2005, the trade turnover with Belarus grew by 5.7 times from LVL 60 million to LVL 339 million. Exports grew by 1.9 times and imports by 9.3

---

<sup>15</sup> [www.saeima.lv/AK/dokument-koncepcija-div...](http://www.saeima.lv/AK/dokument-koncepcija-div...)



times. In 2006, the turnover increased less than before to LVL 374 million, or by 10%. The exports grew faster by 32%, while imports only by 6%.

In 2006, the Latvian exports to Belarus comprised 2.3% of Latvia's total exports, and imports made up 4.7% of Latvia's whole imports. These figures show that the volume of trade is unjustifiably low for neighbouring countries, and there are big opportunities for increasing trade.

Latvia exports optical devices and equipment, food industry products, textile materials and products, chemical industry and associated sector products, machinery, mechanisms and electrical devices to Belarus.

Mineral products – petrol oil and oils obtained from bitumen minerals, salt, cement, coal tar oil and other products, as well as oil coke, oil bitumen and other oil by-products are imported from Belarus. Metals and metal products, timber and timber products, transport vehicles, stone, gypsum, cement, glass and ceramic products are also imported.

Since 1995 the balance of the Latvia-Belarus trade has significantly worsened. Before 1995, Latvia's exports to Belarus exceeded imports. In 1995, the gap closed and imports from Belarus slightly exceeded (by 1%) the Latvian exports to it. Since 1998 the dominance of imports over exports has increased. In 2005, imports exceeded exports by 4.9 times. In 2006, Latvia's trade balance with Belarus slightly improved – imports exceeded exports 'only' by 3.9 times.

The gap is caused to a great extent by imports of mineral products – 70% of total imports from Belarus to Latvia, which have grown especially since 2003. Figure 2 (see Appendix) shows that structure of exports and imports is rather stable, and there are product groups where Latvia exports to Belarus more than it imports from Belarus.

Figures 3-11 show the development of the bilateral trade by the main product groups (see Appendix). No improvements can yet be detected in redressing the export/import imbalance. Exports are diversified, but amounts are small. Major exported product groups are connected with industries whose competitiveness may be questioned due to raising

labour costs (textiles and articles of textiles products, food industry), or from small scale sectors (chemical and allied industries, machinery and mechanical appliances). On contrary, the imported products are essential for Latvia's development and imports cannot be reduced.

In 2006, slight improvement in Latvia's trade balance with Belarus was caused by a smaller amount of imports of mineral products rather than by increasing exports. Besides, fluctuating rates and their scale (two digit increase or decline rate) may be explained by small scale of trade totals.

It is questionable, what is the impact of Latvia's EU membership on trade with Belarus. It is likely that there is no direct impact, while indirect impact exists. Improving financing of Latvia's economy after joining the EU in May 2004 has resulted in fast increasing domestic demand. As the import development shows, Belarus has responded to this demand. It has caused a further deterioration of Latvia's foreign trade balance with Belarus.

## **5. Investment**

In recent years, Latvian entrepreneurs have started seeking investment opportunities abroad. There are several reasons for this. Latvia does not have a goal-oriented economic policy or investment policy. As a result, the direction of investment is determined by the market. Investment is concentrated in the area with the highest return, i.e. real estate. This situation is facilitated by a boom in mortgage lending and activity by foreign banks in providing cheap credit resources. Investments in other areas produce lower returns and are not worthwhile. This means that entrepreneurs who do not wish to invest in real estate are looking for opportunities abroad.

Latvian entrepreneurs also have available funds due to the fact that immediately after accession to the European Union the owners of many manufacturing enterprises sold their companies out of fears about their deteriorating competitiveness in the common economic space. Since Latvia does not have a goal-oriented economic policy, entrepreneurs have

not been investing in fields where the rate of return is slower (industry), and equipment purchased in the early 1990s is now obsolete.

Latvian enterprises are small and produce traditional products, and therefore their survival in global competition conditions is problematic. Up to the start of the 21<sup>st</sup> century, the competitiveness of Latvia's enterprises was based on low costs, but as already mentioned, these have risen strongly after the EU accession.

Despite motivating circumstances, Latvia's investments in foreign countries are tiny. As of September 2006, LVL 227 million had been invested from Latvia overseas, of which LVL 135 million comprised equity capital and reinvested earnings, and LVL 92 million was other capital.<sup>16</sup>

Latvian investments in Belarus are small and statistical data in this regard is insignificant and contradictory. It is known that at the end of 2005, LVL 7 million had been invested in the Belarusian economy from Latvia.<sup>17</sup> The largest investments have been made by financial, pharmaceutical and forestry enterprises. Several Latvian banks are represented in Belarus. Pharmaceuticals producers AS Grindekss and AS Olainfarm and lingerie maker AS Lauma sell their products in Belarus. The largest investments have been made by timber processors. For example, AS Lindex has a plant in Belarus.

Foreign investors and international financial organisations consider the main negative aspects of the Belarusian business environment to be: state-imposed administrative barriers, state meddling in private business with control and licenses, changeable laws and a lack of guarantees, and also corruption. Latvian entrepreneurs also mention special supervision of certain sectors (for example, timber processing), frequent changes to regulations, the tax system which is structured on the fiscal principle rather than to promote business, a complex base of laws and a high level of bureaucracy, high rent costs, difficulty in finding premises, as the majority of buildings are under state control. But Latvian entrepreneurs stress that although it is strictly controlled, there is order in the

---

<sup>16</sup> Monthly Bulletin of Latvian Statistics, 2006, 12 (151), Central Statistical Bureau of Latvia, Riga, December 2006, p. 82.

<sup>17</sup> Elizabete Rutule. Investējiet, cik nav žēl zaudēt. Diena, October 31, 2006.

country. If the state requirements are followed closely, Belarus is a very promising country for businesses<sup>18</sup>.

The main advantages are the large domestic market, low production costs, including low labour costs, geographic proximity to the markets of developed European countries, developed industry and an industrial workforce, and the rising living standards of inhabitants in recent years. There are much more advantages than disadvantages, and furthermore many of the stated drawbacks may be less problematic than they seem at first, and therefore there is a lot of interest towards Belarus. The inflow of foreign capital is hampered by administrative barriers – Belarus does not want to see many foreigners in its economy, and due to the size of the country and its resources, for the moment it can afford this stance.

Latvian entrepreneurs are hopeful about co-operation with Belarus, although they note some problems with investing there. Businesses consider that in Belarus the views of the state authorities must be taken into account and it is forbidden to make negative reports about the country. Investment which may be economically advantageous can be politically dangerous – any investment is influenced by many subjective factors which may result in losses.

Latvia's large enterprises have successful co-operation with Belarus. However, the Belarusian business environment is not favourable to small enterprises.

Activity of Belarusian investors in Latvia is even weaker. The Latvian Ministry of Economics (referring to Lursoft, who operates company register in Latvia) reports that at the end of the 1<sup>st</sup> half of 2006, 299 Latvian-Belarusian joint ventures<sup>19</sup> were operating, and Belarusian entrepreneurs had invested LVL 5 million in Latvia, and investments in companies' equity were LVL 2 million. These are insignificant amounts, but the trend is for them to increase. In 2004, 281 Latvian-Belarusian joint ventures were operating in Latvia.

---

<sup>18</sup> Elizabete Rutule. Investējiet, cik nav žēl zaudēt. Diena, 2006, gada 31. oktobris.

<sup>19</sup> Press release of RL Ministry of Economics, [www.em.gov.lv/](http://www.em.gov.lv/)

According to the Ministry of Economics, investments from Belarus are mainly in the retail, real estate, legal, bookkeeping, accounting and auditing spheres. There is no Belarusian investment in the production sphere.

The Bank of Latvia which gathers statistics on foreign investment reports other figures. It reports that in June 2006 there was a total of LVL 729,900 of investment into the equity of Latvian companies from Belarus – a miniscule amount, and just a half of what it was in 2003 (see Appendix: Table 1). In September 2006, the amount was even smaller – LVL 587,600. Investments are noted in five sectors, of which the largest are timber processing (40% of the total volume) and wholesale (47%). According to statistics, the volume and structure of investment are changing, and differs from that indicated by the Ministry of Economics.

A lack of statistical data hampers a comprehensive analysis of investment. Examples from business activities show that co-operation exists, but is cautious and far from reaching its full potential.

## **6. Tourism between Latvia and Belarus**

On average, annually 6-8% of all Latvian travellers abroad visited Belarus in 2000-2005<sup>20</sup>. A number of visitors from Belarus has been around 200,000 people per year (201,800 people in 2005). Among neighbouring countries, Belarus has the lowest share of travellers from Latvia (Russia accounts for 14% of all travellers, Estonia 20%, and Lithuania 30%). However, Latvia's share is comparable with Germany and Poland (accounting for 5% of all travellers each). Two thirds of the Latvian residents travelling to Belarus are one-day guests. For instance, in Germany or Poland almost all travellers from Latvia stay for several days.

The major purpose of a trip to Belarus is visiting friends and relatives (77% of all trips in 2005), followed by shopping (8% of all trips). Latvian residents stay less than average time in Belarus, i.e. 1.6 nights, compared with 2.9 nights on average, and spend twice less

---

<sup>20</sup> All data from Tourism in Latvia in 2005. Central Statistical Bureau of Latvia, Riga, 2006.

money, compared with average expenditure per traveller (LVL 17.4 and LVL 35.2 respectively). Both facts may be explained by a high share of one-day guests among the travellers.

In 2005, the Latvian residents spent in Belarus LVL 5.7 million in total – more than in 2004 (LVL 2.6 million) and 2000 (LVL 3.1 million). 22% of Latvian residents travelling to Belarus consider their trip as very good, 48% say it was good, and 30% assess it as satisfactory. The relevant average estimations are 44%, 40% and 15%.

Much smaller amount of Belarusians, about 42,000 people, visited Latvia in 2005. The number of visitors from Belarus has been stable – less than 50,000 people per year – during the period 2000-2004. Belarus accounts for only 1% of non-resident travellers whose country of destination was Latvia, and this share declines. The number of visitors from Russia exceeds this figure by 6 times, Estonia 23 times, Lithuania 32 times, and Poland 5 times.

About a half of visitors from Belarus are one-day guests. In 2005, 48% of all visitors from Belarus arrived in Latvia to visit friends and relatives and 15% arrived for business purposes. 16% of the Belarusians were transit travellers. The high share of transit travellers explains a large share of one-day visitors. The average length of stay of the Belarusian in Latvia is longer than Latvian residents stay in Belarus. In 2000, the visitors from Belarus stayed in Latvia for 3.1 nights, in 2004 for 3.6 nights and in 2005 for 4.6 nights.

Average daily expenditures per person are lower for visitors from Belarus – LVL 15, and this is less than average spending of non-resident visitors in Latvia (LVL 33). In 2005, visitors from Belarus spend in Latvia LVL 3 million – much more than in previous years but less than Latvian visitors spend in Belarus. In result, tourism balance between Latvia and Belarus also deteriorates (see Appendix: Figure 12).

Only 10,800 visitors from Belarus stayed in hotels and other accommodation establishments (mostly in hotels) in Latvia, spending there 98,500 nights (on average 9.1 nights per traveller).

## **7. Other co-operation**

In recent years, co-operation in the sphere of social processes has become more active. At the end of 2006, the tender INTERREG IIA Southern Priority was announced. It supports co-operation between Latvia, Lithuania and Belarus. INTERREG IIIA Southern Priority is being introduced under the auspices of the Baltic Sea region INTERREG IIIB Neighbourly Relations programme. The aim of the Southern Priority is to exploit the potential of cross-border co-operation to promote socially economic development in border regions. It is financed from the European Regional Development Fund (ERDF) and the EU Tacis Program, with co-funding by partners.

Projects supported by the announced tender project promote co-operation in society and enhancement of trans-border infrastructure. Co-operation in society anticipates the development of contacts, co-operation networks and joint activities, creation of projects and strategies and exchange of experience. The aim of the programs activities in the sphere of enhancing infrastructure is to reduce physical barriers to transborder co-operation.

On Latvia's side, the co-operation partners are the border regions – Latgale, Zemgale and Kurzeme. In Belarus, the regions of Vitebsk, Minsk and Grodno can participate in the projects. The projects must be large (minimum EUR 0.5 million, recommended EUR 0.8-1.0 million). The main beneficiaries must be Belarusian partners. The partners may be municipalities, state and regional bodies, research and teaching institutions, foundations, schools and universities.

## **8. Future prospects**

The economy of Belarus is attractive to the Latvian producers and investors, but it is not an easy market to enter. Uncertainty over the country's future creates a heightened risk. Latvian entrepreneurs consider that Belarus economic achievements to date have been due to access to cheap natural resources subsidised by Russia and unrestricted market. If relations with Russia worsened, the Belarusian economy may suffer badly.

Latvian entrepreneurs consider that the present difficulties created by the unsatisfactory business environment will continue for as long as there are strict state controls. But others consider that the firm hand brings order which is good for business. It is not yet clear whether and how the form of state administration could change, since the Belarusian society does not support changes.

Notwithstanding that co-operation is currently insignificant Belarus will continue to be an important partner for Latvia because it is a geographical neighbour. The countries have common environmental, social and infrastructure problems. The attitude towards Belarus is favourable in business society, and unused potential is high.

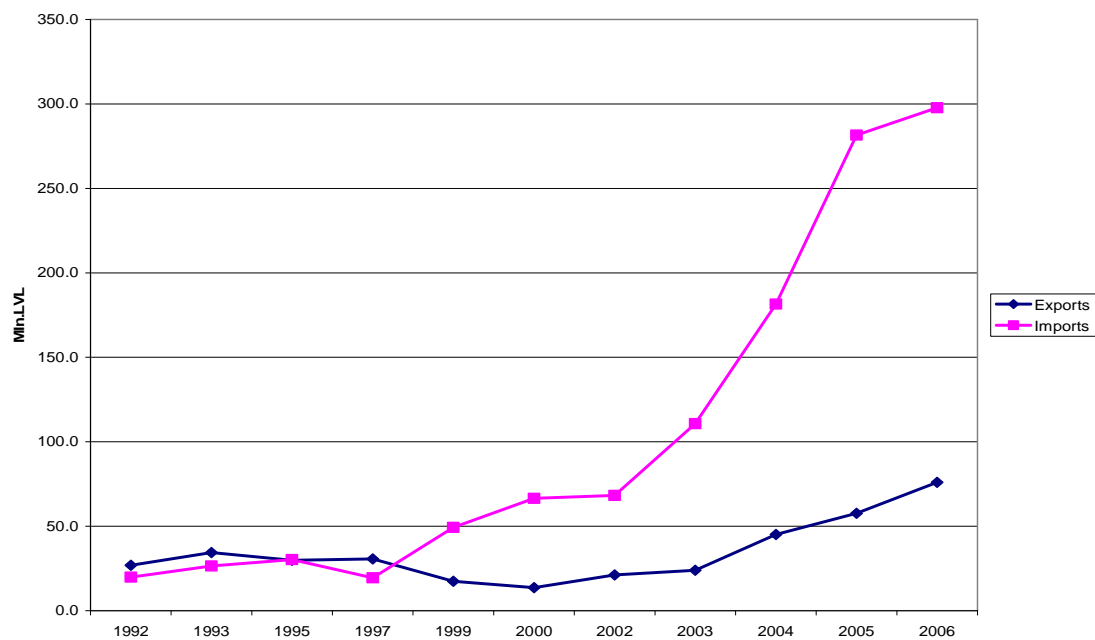
Apart from existing more measures would be highly welcomed in order to increase mutual co-operation. From Latvia's point of view, first and foremost it is necessary to reduce trade deficit between Latvia and Belarus by increasing the Latvian exports to Belarus. For this the export promotion policies must be more effectively expanded to Belarus. Co-operation at the level of state institutions, such as embassies and ministries would be needed in order to eliminate bureaucratic obstacles for foreign trade of goods and services. The same relates to facilitating of mutual investment exchange that also may produce exports to Belarus.

Second, the situation must be adequately assessed as Latvia's economy does not for the time being produce enough exportable products. Serious efforts must be taken to retrace the Latvian economy from the highly profitable but fragile real estate sector to the more sustainable sectors producing exportable products and services.

Third, the situation in tourism must be improved. It must be understood why travellers from Belarus do not find Latvia attractive for their trips or what obstacles prevent their visits to Latvia. The government has taken further steps in developing the Latvia-Belarus relations. Belarus is among countries which are included in the Development Co-operation Policy implemented by Latvia. According to the Latvian Ministry of Foreign Affairs: *"Latvia is interested to promote co-operation also with Belarus, however such co-operation can occur at present only in specific areas, like civil society development, etc."*. Unfortunately, the government plans regarding economic relations with Belarus remain uncertain.

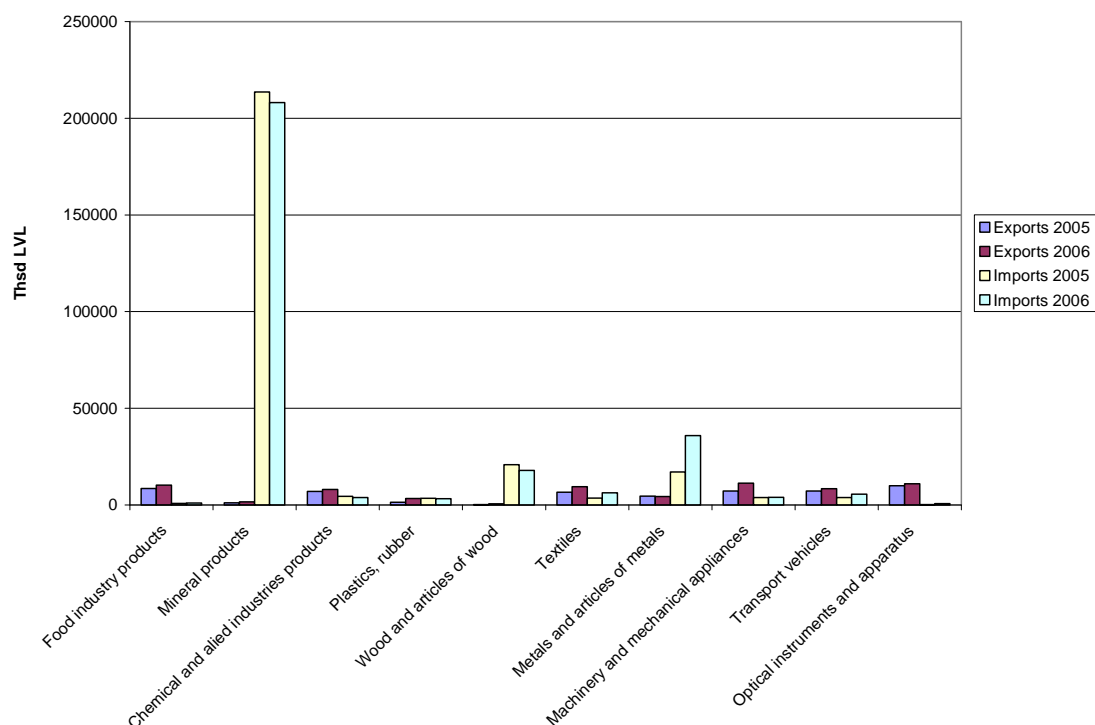


**Appendix: Figure 1. Latvian-Belarusian trade, LVL million**



In LVL mn	1992	1993	1995	1997	1999	2000	2002	2003	2004	2005	2006
Exports	26.9	34.4	29.9	30.6	17.4	13.7	21.2	23.9	45.1	57.6	75.9
Imports	19.9	26.5	30.3	19.5	49.3	66.5	68.2	110.8	181.5	281.5	297.7

Figure 2. Largest commodity groups in exports and imports, Latvia-Belarus in 2005-6



In LVL 1000	Exports 2005	Exports 2006	Imports 2005	Imports 2006
Food industry products	8 514	10 258	794	1 054
Mineral products	1 151	1 665	213 556	208 089
Chemical and allied industries products	7 030	8 053	4 476	3 904
Plastics, rubber	1 460	3 362	3 449	3 209
Wood and articles of wood	211	611	20 881	17 944
Textiles	6 636	9 432	3 535	6 256
Metals and articles of metals	4 527	4 422	17 121	35 934
Machinery and mechanical appliances	7 195	11 281	3 883	3 941
Transport vehicles	7 195	8 429	3 883	5 591
Optical instruments and apparatus	9 988	11 006	211	762

Figure 3. Development of exports and imports of mineral products: Latvia-Belarus

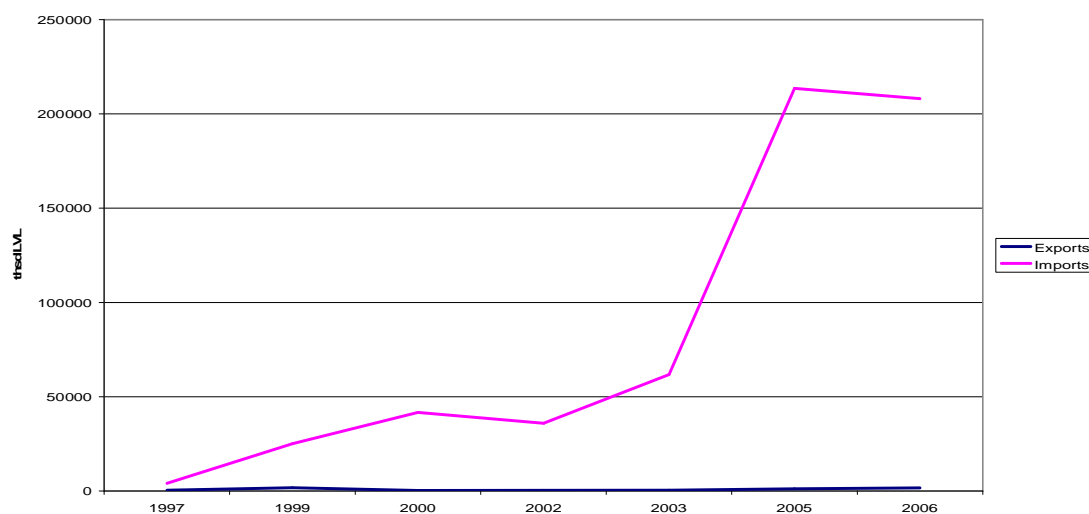


Figure 4. Development of exports and imports of food industry: Latvia-Belarus

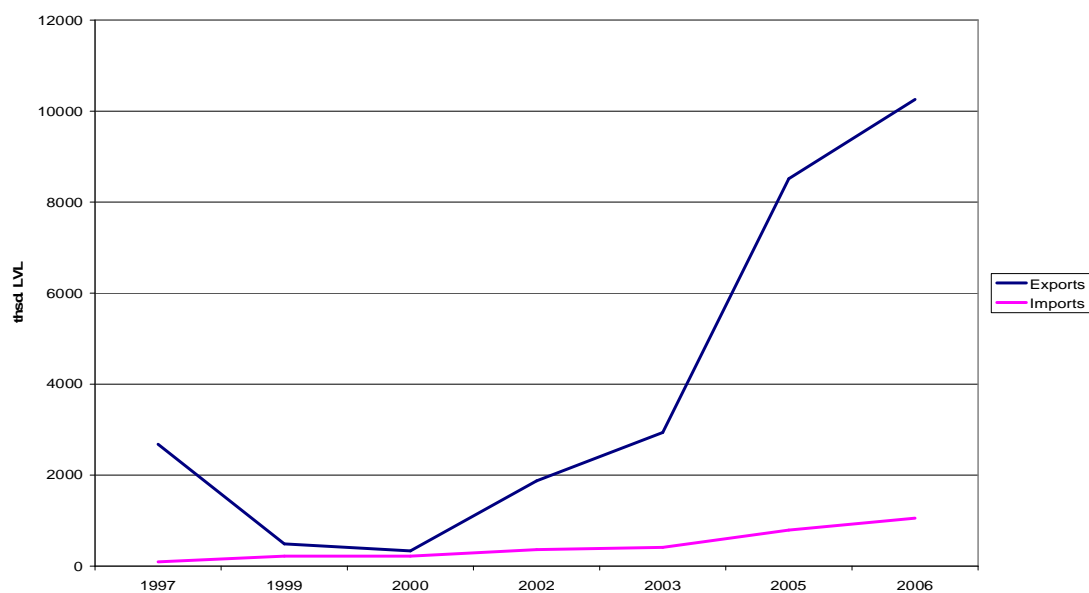
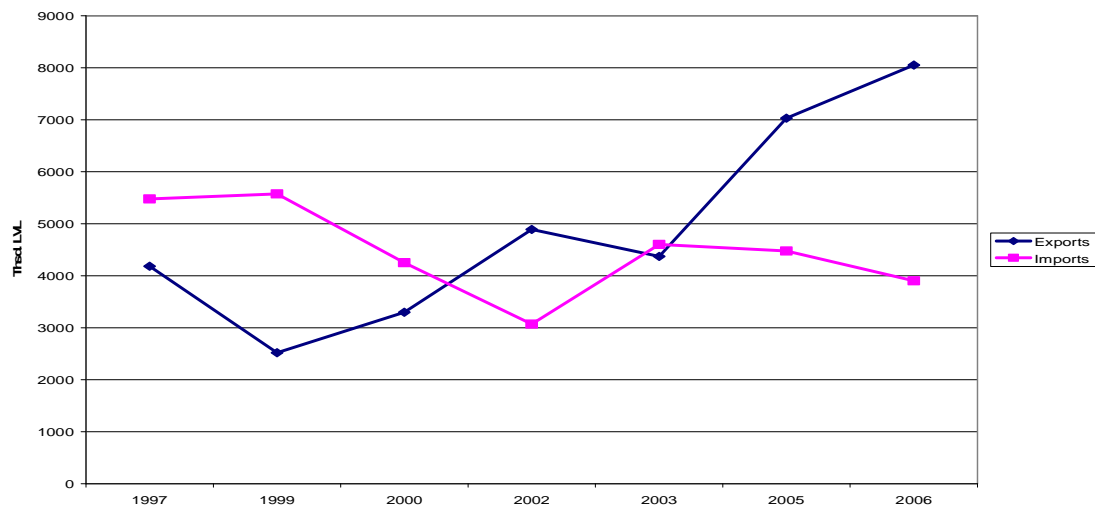
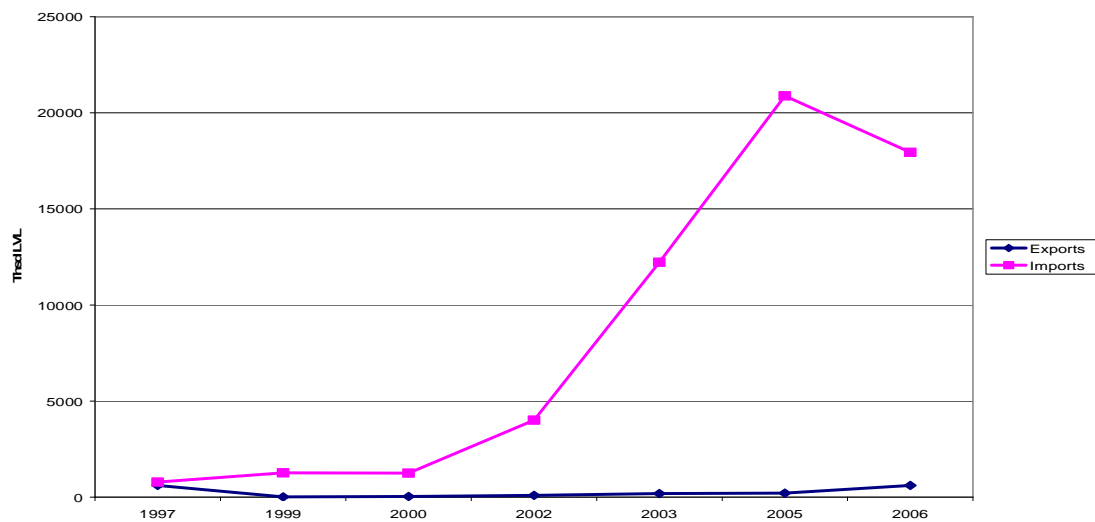


Figure 5. Development of exports and imports of products of the chemical and allied industries: Latvia-Belarus



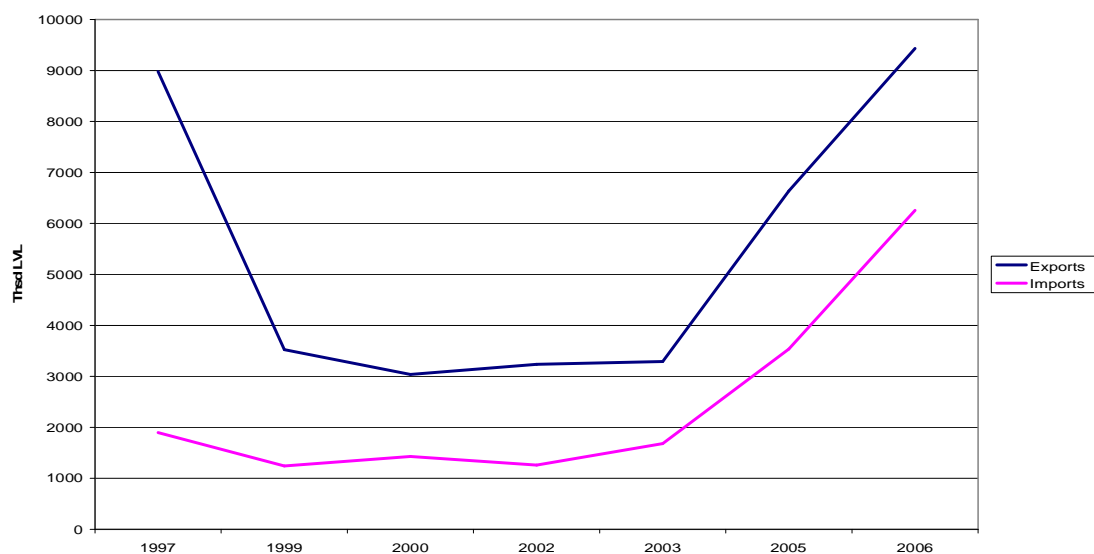
In LVL 1000	1997	1999	2000	2002	2003	2005	2006
Exports	4183	2521	3298	4889	4372	7030	8053
Imports	5477	5574	4252	3070	4602	4476	3904

Figure 6. Development of exports and imports of wood and articles of wood: Latvia-Belarus



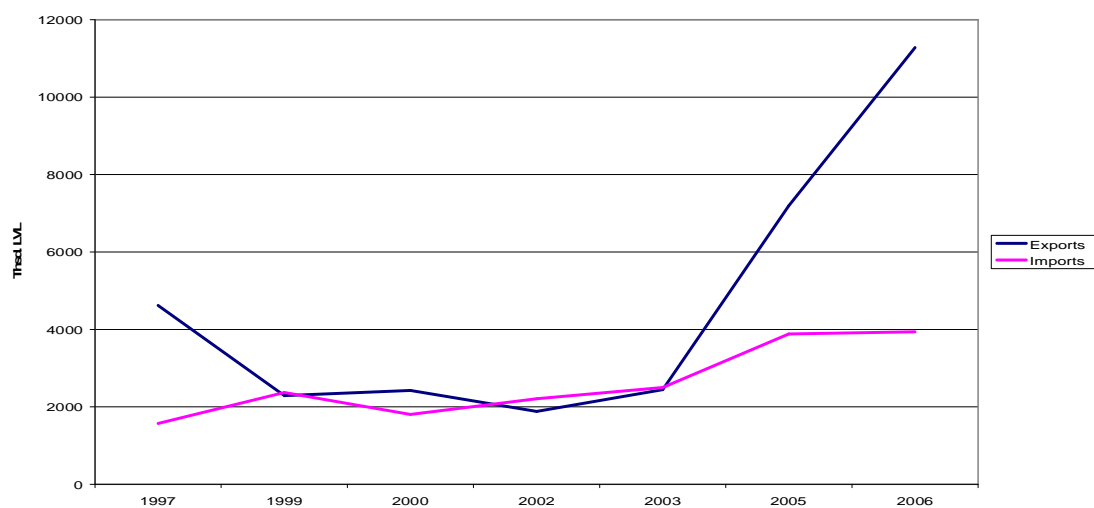
In LVL 1000	1997	1999	2000	2002	2003	2005	2006
Exports	613	14	34	94	191	211	611
Imports	784	1 264	1 251	4 011	12 224	20 881	17 944

Figure 7. Development of exports and imports of textiles and textile articles: Latvia-Belarus



In LVL 1000	1997	1999	2000	2002	2003	2005	2006
Exports	8978	3523	3039	3235	3292	6636	9432
Imports	1898	1242	1429	1260	1681	3535	6256

Figure 8. Development of exports and imports of machinery and mechanical appliances: Latvia-Belarus

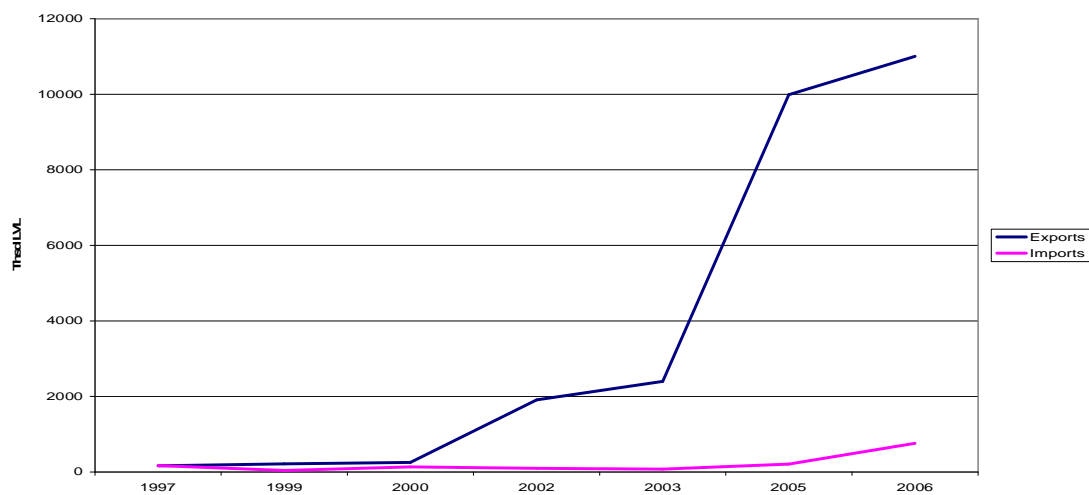


In LVL 1000	1997	1999	2000	2002	2003	2005	2006
Exports	4621	2290	2424	1884	2446	7195	11281
Imports	1572	2371	1804	2212	2501	3883	3941

Figure 9. Development of exports and imports of transport vehicles: Latvia-Belarus

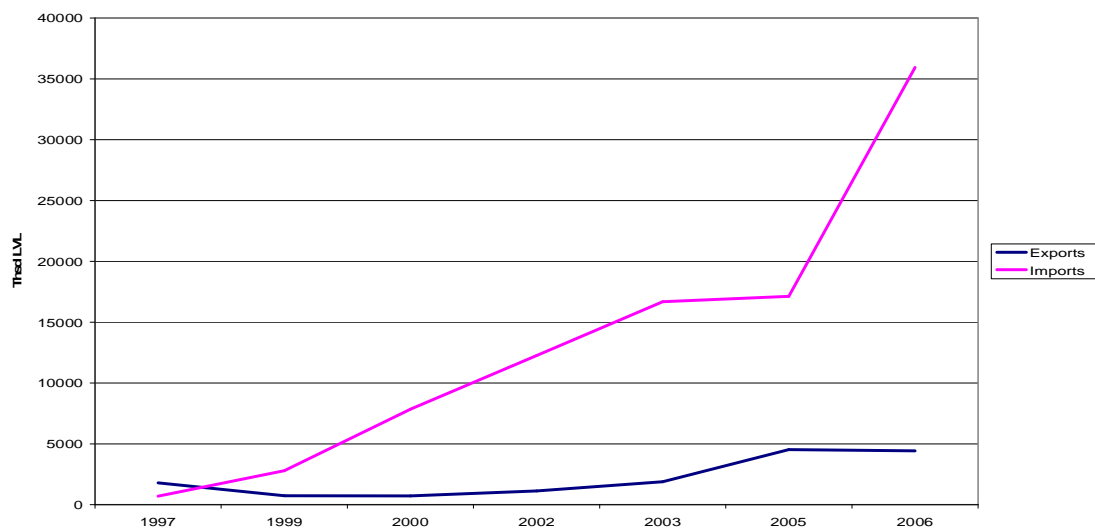


Figure 10. Development of exports and imports of products of optical instruments and apparatus: Latvia-Belarus



In LVL 1000	1997	1999	2000	2002	2003	2005	2006
Exports	165	218	254	1 911	2 401	9 988	11 006
Imports	170	41	137	99	76	211	762

Figure 11. Development of exports and imports of metals and articles of metals: Latvia – Belarus



In LVL 1000	1997	1999	2000	2002	2003	2005	2006
Exports	1791	734	720	1131	1884	4527	4422
Imports	702	2797	7842	12262	16683	17121	35934

Table 1. FDI stock of the Belarus-owned enterprises in Latvia, LVL 1000

Activity, NACE code	1992	1993	1995	1997	2000	2002	2003	2004	2005
Manufacture of food products and beverages (15)	*	*	*	*	*	10.0	10.0	*	*
Manufacture of textiles (17)	*	*	10.5	19.0	19.0	0	0	0	71.1
Manufacture of wearing apparel; dressing and dyeing of fur (18)	0.9	0.9	6.8	*	*	*	*	*	*
Manufacture of wood and of products of wood and cork (20)	*	*	*	26.0	98.8	26.8	26.8	0	237.6
Publishing, printing and reproduction of recorded media (22)	*	*	*	*	1.0	1.0	1.0	*	*
Manufacture of other transport equipment (35)	*	*	*	*	*	0.8	0.8	*	*
Manufacture of furniture; manufacturing n.e.c. (36)	0.1	0.1	*	*	*	*	*	*	*
Construction (45)	*	0.1	*	*	*	*	*	*	*
Sale, maintenance and repair of motor vehicles and motorcycles; retail trade of automotive fuel (50)	0.6	0.7	*	*	0.2	32.0	88.1	0	*
Wholesale trade and commission trade, except of motor vehicles and motorcycles (51)	3.9	65.7	99.9	60.8	33.1	105.5	275.5	250.0	283.6
Retail trade, except of motor vehicles and motorcycles; repair of personal and household goods (52)	0.1	0.2	386.7	0.6	2.0	4.0	4.0	*	*
Land transport, transport via pipelines (60)	*	*	*	28.3	*	*	*	*	*
Financial intermediation, except insurance and pension funding (65)	23.2	70.8	79.0	*	67.8	*	*	*	*
Real estate activities (70)	*	*	*	*	*	*	*	*	2.0
R&D (73)	0.1	0.1	*	*	*	*	*	*	*
Other business activities (74)	0.1	0.1	*	2.0	*	*	*	*	*
Health and social work (85)	*	*	1069.6	1819.0	1536.4	1536.4	773.9	3.0	3.0
Not classified (00)	*	*	*	*	...	137.3	137.3	*	*
<b>Total</b>	<b>29.0</b>	<b>138.7</b>	<b>1652.5</b>	<b>1955.7</b>	<b>1758.3</b>	<b>1853.8</b>	<b>1317.4</b>	<b>253.0</b>	<b>597.3</b>

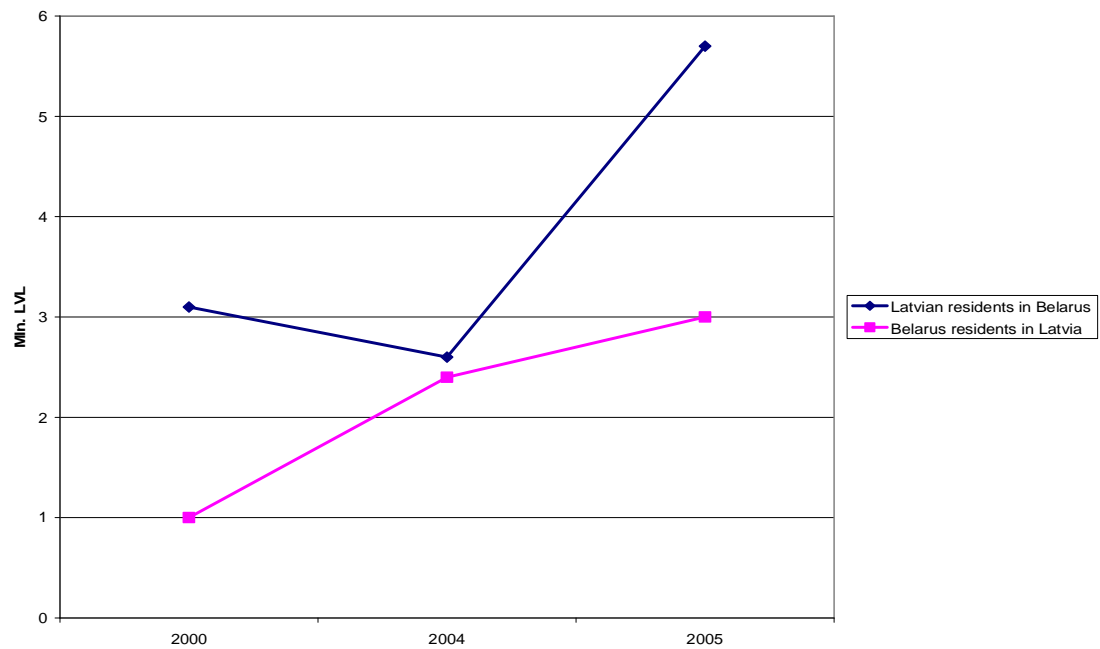
Source: Investment in Latvia, Central Statistical Bureau of Latvia, relevant years

... Data is not available

\* Occurrence is not reported



Figure 12. Total expenditure of travellers



In LVL million	2000	2004	2005
Latvian residents in Belarus	3.1	2.6	5.7
Belarus residents in Latvia	1.0	2.4	3.0

# **Lithuania-Belarus economic relations: How the EU accession impacted bilateral trade**

Abel Adekola, Romualdas Ginevicius, Manuela Tvaronaviciene,  
Renata Korsakiene and Kristina Kalasinskaite

## **Contents**

1.	Introduction	73
2.	The trade trends between Lithuania and Belarus	73
3.	Impact of new trade regime on the Lithuanian-Belarusian trade	78
4.	Tourism	80
5.	Conclusions	80
	Literature	81

## **1. Introduction**

Trade in Lithuania developed to a remarkable extent in the 1990s. This increase was influenced by such processes as the transition to a market economy, gradual integration with the EU market (Association agreement signed bilaterally), FDI inflows and so on. Traditionally, the most active trade relations are between Lithuania and its neighbouring countries. Belarus, bordering Lithuania to its north, historically has developed tight economic connections. A glance at statistical data verifies that the importance of Belarus as a trading partner during recent years cannot be straightforwardly viewed as diminishing despite changed trade conditions. Lithuania, together with nine other Central and Eastern European countries, joined the EU on 1 May 2004. The accession process was followed by the adoption of the EU's common trade policy which includes all trade agreements concluded between the EU and third countries by that day. Hence, the new trading regime with Belarus is seen as the one of the reasons causing changes in trade relations<sup>1</sup>.

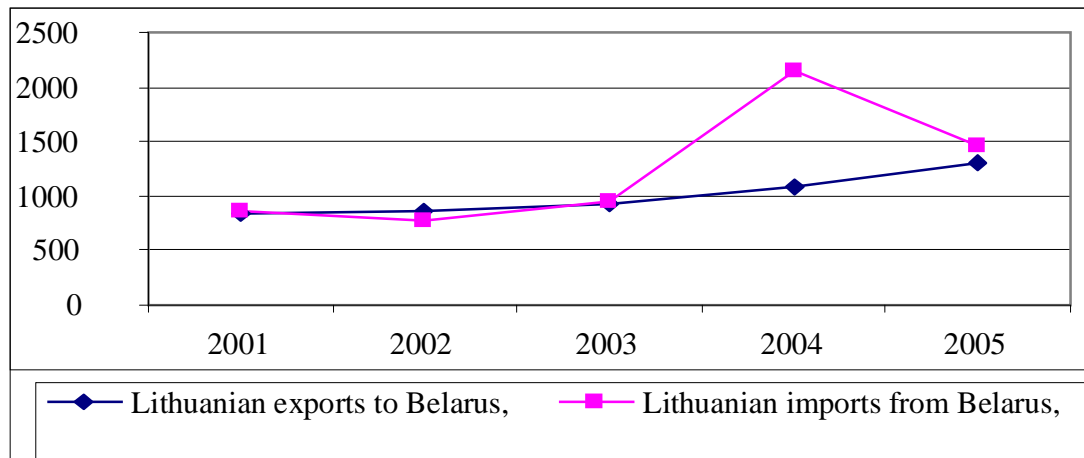
## **2. The trade trends between Lithuania and Belarus**

The Lithuanian-Belarusian export-import tendencies recorded before and after Lithuanian accession reveal steady growth of the Lithuanian exports to Belarus and uneven development of the Lithuanian imports from Belarus (Chart 1 and Table 1). Notably, the rise of the exports to Belarus was gradual throughout years 2001-2005. The imports from Belarus grew especially significantly during pre-accession year (128%), and later dropped significantly. A closer look at the Lithuanian-Belarusian trade by product groups indicates that the recorded grow of imports was achieved mainly at account of mineral products (297%), wood and articles of wood (123%); prepared foodstuffs; beverages, spirits and vinegar; tobacco (111%). In contrast, a gradual grow of exports took place mainly due to trade in products of agriculture (88%), wood and articles of wood (80%), prepared foodstuffs, beverages, spirits and vinegar, tobacco (63%), products of the chemical or allied industries (40%), and textiles and textile articles (40%).

---

<sup>1</sup> There is vast literature which considers the factors affecting the changes in trade between new member states and ones belonging to another trading blocks (Zghini, 2005; Hamilton, 2005; Tvaronaviciene & Tvaronavicius, 2005; Salinas & Aksoy, 2006; Tarr & Navaretti, 2005).

**Chart 1. The Lithuanian trade with Belarus, LTL million**



**Table 1. Lithuania's trade with Belarus by product groups**

	2003		2004		2005		2003-4		2004-5	
	Exports LTL mn	Imports LTL mn	Exports LTL mn	Imports LTL mn	Exports LTL mn	Imports LTL mn	Exports growth in %	Imports growth in %	Exports growth in %	Imports growth in %
Products of agriculture	116.4	26.0	219.3	25.3	193.5	34.6	88	- 3	- 12	37
Products of manufacturing	814.5	914.8	862.3	2117.2	1106.9	1425.8	6	131	28	- 33
Prepared foodstuffs; beverages, spirits and vinegar; tobacco	37.6	4.7	61.2	9.8	62.9	14.1	63	111	3	44
Mineral products	154.8	388.3	105.9	1540.2	33.8	776.1	- 32	297	- 68	- 50
Products of the chemical or allied industries	79.6	83.4	111.2	90.4	142.0	105.9	40	8	28	16
Wood and articles of wood;	4.5	49.0	8.1	109.4	7.4	129.5	80	123	- 8	18
Textiles and textile articles	36.6	60.8	51.3	62.3	79.4	68.0	40	2	55	9
Base metals and articles of base metal	35.5	40.9	41.7	52.4	39.3	60.5	17	28	- 6	15
The manufacture of skilled-labour-intensive products*	379.8	199.3	407.4	157.8	616.3	162.0	7	- 21	51	3
Others	86.0	88.6	75.7	95.0	126.1	110.6	- 12	7	67	16
<b>Total</b>	<b>930.9</b>	<b>940.2</b>	<b>1081.6</b>	<b>2142.5</b>	<b>1300.4</b>	<b>1460.4</b>	<b>16</b>	<b>128</b>	<b>20</b>	<b>- 32</b>

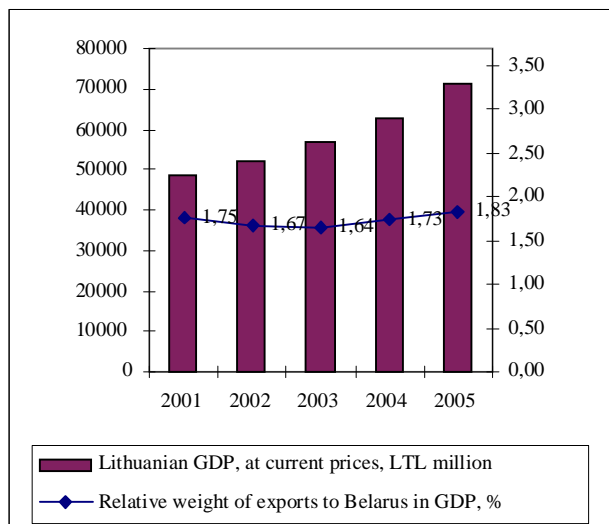
Source: The Customs Department under the Ministry of Finance of the Republic of Lithuania \*\* corresponding period of previous year = 100

The transition to the EU's foreign trade regime had no significant impact on the exports to Belarus and the rise of exports to Belarus remained steady throughout 2005 (20%). However, the analysis of available figures by product groups lets us reveal the decrease of exports of mineral products (-68%), agriculture products (-12%), and wood (-8%). Notably, the growth of exports was achieved mainly in textiles and textile articles (55%), the manufacture of skilled-labour-intensive products (51%) and other products (67%).

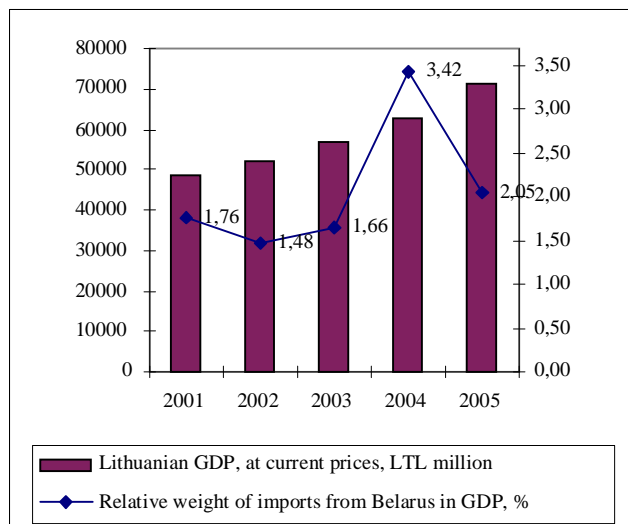
To sum up, an increase of import tariffs applied to third countries, caused a decrease of the Lithuanian imports from Belarus (-32%). The decrease was especially significant in trade of mineral products (-50%). Imports of such product groups as wood and articles of wood (18%), prepared foodstuffs, beverages, spirits and vinegar, and tobacco (44%) dropped significantly as well.

The absolute Lithuanian-Belarusian trade data, which indicates volumes of goods traded, does not provide actual tendencies if the growth of Lithuania's GDP is not being taken into account. The clear rationale lies behind if trade is developing its share or relative weight in GDP grows as well, and vice versa. Judging from the recent statistical data, Lithuania's GDP has been growing since 2001 (Chart 2). Exports to Belarus growing in absolute figures decreased slightly after the accession but later gradual growth recovered. Imports, expressed in terms relative to GDP, replicated the already traced tendency. In 2004, the relative weight of the imports from Belarus rose in Lithuania's GDP up to 3.42 %, which was the highest share achieved in the five years period (Chart 3). In 2005, this rate dropped to 2.05% and was slightly higher than in 2003. Hence, we can conclude that accession impacted imports from Belarus rather significantly.

**Chart 2. Change in relative weight of the Belarus exports in Lithuania's GDP**



**Chart 3. Change in relative weight of the Belarus imports in Lithuania's GDP**

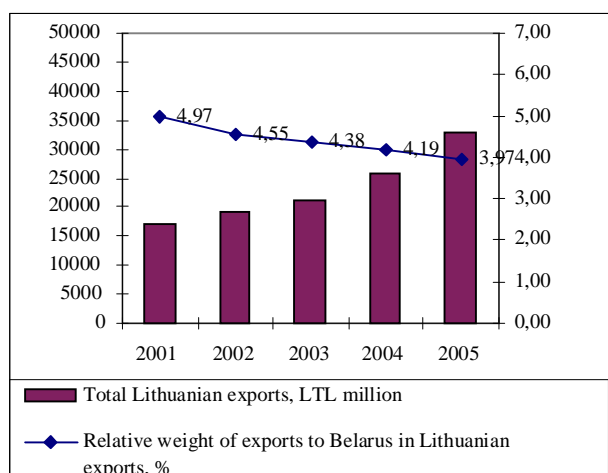


Source: Balance of Payments of the Republic of Lithuania of 2005

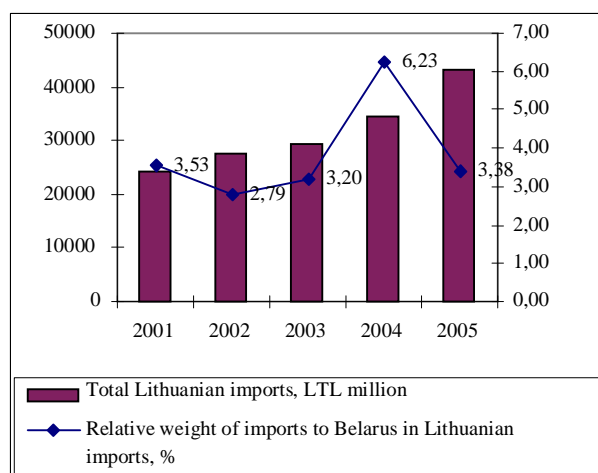
Lithuania's exports verifies that during the last five years exports have grown steadily, however, during the same period the relative weight of the exports to Belarus in Lithuania's total exports declined every year. The situation allows us to conclude that Lithuania switched its exports from Belarus. The Lithuanian exports expanded but they shifted to other, most likely, European countries. The relative decrease of the Lithuanian exports to Belarus was neutralised by the general expansion of the exports. As a result, the absolute volume of the exports to Belarus increased but in principal, the exports to Belarus started gradually to lose its economic importance.

What comes to the Lithuanian imports from Belarus, it provides additional consistent evidences about the declining significance of Belarus as a trading partner, i.e. we can claim a change in foreign trade regime with third countries after the EU accession had direct impact on Lithuania's imports from Belarus (Charts 4 and 5).

**Chart 4. Change in relative weight of Belarus in the Lithuanian exports**



**Chart 5. Change in relative weight of Belarus in the Lithuanian imports**



Source: Balance of Payments of the Republic of Lithuania of 2005

Let us just take a short glance at changes in exports and imports of the Lithuanian services before and after the EU accession. The relative weight of the Lithuanian exports to Belarus in the total exports of the Lithuanian services decreased from 10.06% in 2004 to 7.35% in 2005 (Table 2). Respectively, the imports of services from Belarus decreased from 7.57% in 2004 to 5.68% in 2005. To generalise, despite trade, services were not as significant before nor after the accession, in fact, a decrease can be observed.

**Table 2. Trade of Lithuanian services**

	2004		2005	
	Exports LTL mn	Imports LTL mn	Exports LTL mn	Imports LTL mn
Total Lithuanian services, LTL million	6797.63	4534.74	8641.42	5715.36
of which:				
Belarus, LTL million	683.96	343.39	634.79	324.37
Relative weight in total Lithuanian services, %	10.06	7.57	7.35	5.68

Source: Balance of Payments of the Republic of Lithuania of 2005

### **3. Impact of new trade regime on the Lithuanian-Belarusian trade**

Lithuania's entry to the EU influenced the trade with Belarus. The exports of manufacturing goods grew by 5% in 2005. The Lithuanian exporters were facing full customs duties as well as the quota structure in the agricultural sector. Hence, products of agriculture fell by 5% in 2005.

In 2004, the skilled-labour-intensive products (38%), products of the chemical or allied industries (10%) and mineral products (10%) dominated in the Lithuanian exports to Belarus. In 2005, the share of skilled-labour-intensive products in the Lithuanian-Belarus exports increased by 47 % (Table 3).

The Lithuanian exporters consider Belarus as an attractive market for the skilled-labour-intensive products. The exports of this product group have increased since 2001. However, the importance of mineral products in the Lithuanian exports to Belarus is diminishing. After their steady growth until 2003, they encountered a sharp decrease. Correspondingly, the share of agriculture products in Lithuania's imports from Belarus is decreasing (Table 4).

To generalise, mineral products take the major share in Lithuania's imports from Belarus. The fast increase of their share in 2002 was followed by a sharp decrease after the adoption of the new trading regime. The imports of the skilled-labour-intensive products has taken the second place in the structure of imports. After the EU accession, no visible increase in imports of any kinds of products has been recorded.



**Table 3. The structure of the Lithuanian exports to Belarus, %**

	2001	2002	2003	2004	2005
Products of agriculture	19	11	13	20	15
Products of manufacturing	81	89	87	80	85
Prepared foodstuffs; beverages, spirits and vinegar; tobacco	6	5	4	6	5
Mineral products	10	15	17	10	3
Products of the chemical or allied industries	8	10	9	10	11
Wood and articles of wood;	0	1	0	1	1
Textiles and textile articles	4	4	4	5	6
Base metals and articles of base metal	4	4	4	4	3
The manufacture of skilled-labour-intensive products*	37	39	41	38	47
Others	12	12	9	7	10

**Table 4. The structure of the Lithuanian imports from Belarus, %**

	2001	2002	2003	2004	2005
Products of agriculture	7	4	3	1	2
Manufacturing	93	96	97	99	98
Prepared foodstuffs; beverages, spirits and vinegar; tobacco	0	1	0	0	1
Mineral products	17	13	41	72	53
Products of the chemical or allied industries	10	10	9	4	7
Wood and articles of wood;	3	5	5	5	9
Textiles and textile articles	6	9	6	3	5
Base metals and articles of base metal	30	26	4	2	4
The manufacture of skilled-labour-intensive products*	16	22	21	7	11
Other	10	10	9	4	8

\*Machinery and mechanical appliances; electrical equipment; Vehicles, aircraft, vessels and associated transport equipment; Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; clocks and watches; musical instruments

Source: The Customs Department under the Ministry of Finance of the Republic of Lithuania

#### 4. Tourism

The outbound tourist trips from Lithuania to Belarus were one of the popular trips abroad (15% of all Lithuanian tourist trips abroad). The majority of tourists were one-day visitors (23%) ([www.std.lt](http://www.std.lt)).

The available data related to the tourism from Belarus to Lithuania allows us to conclude that the Belarusian visitors travelled mostly by car (89%) and by rail (11%). The tendencies have shown that the number of visitors decreased from 2002 to 2004. However, the available data shows an increase (14%) in 2005 (Table 5).

**Table 5. A number of visitors from Belarus to Lithuania**

	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
<b>By road</b>	465 276	371 593	356 628	407 230
<b>By rail</b>	178 309	138 215	43 848	47 945
<b>By air</b>	2 464	1 772	1 626	2 066
<b>By sea</b>	721	946	310	524

The visitors from Belarus stayed in Lithuania on average 7 days in 2005. However, the average length of the Belarusian stays decreased (20%) in that particular year. However, the number of the Belarusian guests in the Lithuanian accommodation establishments increased (36%).

#### 5. Conclusions

The rise of Lithuania's exports to Belarus was gradual throughout years 2001-2005. We can conclude that Lithuania is increasingly exporting to Belarus skilled-labour-intensive products.

The Lithuanian imports from Belarus grew significantly prior to the EU accession (128%), thereafter they dropped. A closer look at the Lithuanian-Belarusian trade indicates that the recorded growth in the imports was achieved mainly due to an increase in the imports of mineral products (297%) and wood (123%)

In 2004, in the structure of imports from Belarus, mineral products dominated (72%). However, the change of trading regime diminished the imports of mineral products (to 53%).

The major impact of the EU membership was observed in the Lithuanian imports from Belarus. The growth of the Lithuanian economy and the rise of domestic consumption caused a sharp increase in mineral product imports before the year 2004. However, the adoption of the EU's trading policy has dramatically decreased the imports of this product group after the 1<sup>st</sup> of May, 2004.

## Literature

Balance of Payments of the Republic of Lithuania of 2005

Hamilton Carl B. Russia's European economic integration. Escapism and realities. *Economic Systems*. [Volume 29, Issue 3](#), September 2005, Pages 294-306.

Salinas Gonzalo & Aksoy Ataman. Growth before and after trade liberalization. World Bank Policy Research Working Paper 4062, November 2006

Tarr David G. & Navaretti Giorgio Barba. Introduction and Summary to Handbook of Trade Policy and WTO Accession for Development in Russia and the CIS. World Bank Policy Research Working Paper 3726, October 2005.

The Customs Department under the Ministry of Finance of the Republic of Lithuania

Tvaronaviciene Manuela & Tvaronavicius Vytautas. Some aspects of Lithuanian foreign trade. *Business: Theory and Practice*. 2005, Vol. VI, No. 2, p.117-121.

Zghini Andrea. Evolution of trade patterns in the new EU member states. *Economics of Transition*, Vol. 13(4) 2005, 629-658.

## **Polish-Belarusian economic relations as seen from Poland**

Rafał Sadowski

### **Contents**

1.	The nature of the economic co-operation	83
2.	The legal background	84
3.	The trade exchange	84
4.	Investment co-operation	87
5.	Problems encountered by the Polish business in economic relations with Belarus	88
6.	Barriers in Polish entrepreneurs' access to the Belarusian market	89
7.	Other barriers	90
8.	The advantages of Belarus as an economic partner of Poland	91
9.	Summary	93

## **1. The nature of the economic co-operation**

Although Poland and Belarus are immediate neighbours, economic relations between the two countries are not overly intensive. Their economic co-operation is mainly based on trade exchange. Investment co-operation is marginal. In fact, it is limited to the Polish investments in Belarus.

The fact that the scope of trade co-operation between Poland and Belarus is smaller than could have been expected is due to a number of various barriers. The barriers can be divided into several groups, the most significant of which seem to be the following:

- The Belarusian market is relatively closed to foreign co-operation due to the Belarusian Government's economic policy based on state control, delay of free market reforms, unfriendly investment climate, etc.;
- A lack of complete safety of foreign investments in Belarus due to frequently changing regulations, instable political situation, and strong interference by the state administration to operations of private firms; and
- Bad political relations between Warsaw and Minsk, which prevents developing a favourable climate for trade co-operation. However, in this context it needs to be emphasised that trade co-operation between the two countries is gradually growing regardless of existing political conflicts.

Poland is a one of the major trade partners for Belarus. In 2006, Poland ranked fifth among the key foreign trade partners of Belarus. Trade turnover with Poland accounted for 5% of the foreign trade turnover of Belarus<sup>1</sup>. In turn, Belarus does not play such a significant part in the Polish foreign trade. Its share in Poland's foreign turnover during the first 11 months of 2006 was at 1%<sup>2</sup>. Nevertheless, Belarus is one of the most important trade partners for Poland among CIS countries; only Russia and Ukraine being more significant than Belarus.

This text is intended to present the nature of Polish-Belarusian economic relations, point out the major problems encountered by Polish entrepreneurs doing business in Belarus, and analyse the main advantages of Belarus as an economic partner of Poland.

---

<sup>1</sup> Data according to Ministry of Statistics and Analysis of the Republic of Belarus, [www.belstat.gov.by](http://www.belstat.gov.by)

<sup>2</sup> Data according to the Ministry of Economy of the Republic of Poland, <http://www.mgip.gov.pl>

## **2. The legal background**

The legal base for developing economic relations between Poland and Belarus was created between 1991 and 1996. It consists of over sixty agreements and accords signed at the state, government and ministry levels<sup>3</sup>. One of the key documents is the treaty 'on good neighbourhood and friendly co-operation' signed in Warsaw on the 23<sup>rd</sup> of June 1992.

When Poland joined the European Union, it became necessary to amend the previous legislation pertaining to economic co-operation between the two countries and to adjust it to the requirements set to Poland as an EU member. In 2004, Poland terminated the previous agreement on economic and trade co-operation. The new agreement was signed in Warsaw on the 30<sup>th</sup> of April 2004. It set the rules of trade exchange between the two countries in new conditions determined by Poland's membership in the EU.

## **3. The trade exchange**

Trade exchange between Poland and Belarus has been constantly growing since 2000. Between 2000 and 2005, trade turnover increased from USD 398 million in 2000 to USD 1697 million in 2005, which means a growth by 400%<sup>4</sup>. In 2006, the turnover was USD 1798 million<sup>5</sup>.

Since 2004, Poland has had negative balance in trade exchange with Belarus. In 2004, it was USD 133 million, in 2005 it was USD 256 million and between January and September 2006 it was USD 99 million<sup>6</sup>. This has been caused by growing imports of crude oil and oil products from Belarus and significant increases in their prices over recent years. Prices have played a significant part in the increasing Belarusian exports to Poland. In the case of oil products alone, the growing prices caused an increase in Belarusian

---

<sup>3</sup> *Białoruś – przewodnik dla przedsiębiorców*, 6<sup>th</sup> ed., August 2006.

<sup>4</sup> Quote: Foreign Trade Information Centre, Ministry of Economy of Poland. According to data provided by the Belarusian Ministry of Statistics and Analysis for the same period, trade turnover grew from USD 492 million in 2000 to USD 1426.2 million in 2005, i.e. a 300%-growth.

<sup>5</sup> Data by the Belarusian Ministry of Statistics and Analysis, [www.belstat.gov.by](http://www.belstat.gov.by).

<sup>6</sup> Data by the Polish Ministry of Economy.

exports by 32%, i.e. USD 120 million in 2005<sup>7</sup>.

The commodity structure of the Belarusian exports to Poland has been similar for several years. One of its characteristics is the high concentration in several commodity groups and predominance of raw materials<sup>8</sup>. Such commodity groups as oil products, natural gas, potassium fertilisers, casein and raw wood accounted for 73% of the Belarusian exports in 2005<sup>9</sup>.

**Table 1. The Belarusian exports to Poland (USD 1000)**

<b>Commodity group</b>	<b>2004</b>	<b>2005</b>
Petroleum oils other than crude	298,919.6	380,274.2
Natural gas	57,560.5	114,812.8
Potassium fertilisers	72,303.7	78,488.1
Casein	25,146.1	29,324.8
Raw wood, including roughly squared	8,276.0	22,164.2
Electric energy	17,357.2	20,561.2
Unalloyed steel semi-products	15,181.5	18,429.7
Insulated wires, cables and electric cabling	7,267.4	14,781.4
Tractors	326.1	12,893.1
Coils, ropes, cables and steel tapes	9,476.3	11,666.7
Petroleum oils, crude	69,430.6	0
<b>Total exports</b>	<b>728,753.7</b>	<b>847,344.4</b>

Source: Ministry of Statistics and Analysis of Belarus, May 2006<sup>10</sup>.

The concentration of the Belarusian exports to Poland is even better illustrated by data of the Polish Economy Ministry. Four commodity groups accounted for 93% of the Belarusian exports; mineral products 61%, chemical products 20%, metals and metal products 7%, and wood and wood-related products 4% in 2005<sup>11</sup>.

<sup>7</sup> Information on Polish-Belarusian economic relations in 2005, study by the Trade and Investment Promotion Department, Polish Embassy in Minsk.

<sup>8</sup> This is characteristic of Belarusian exports not only to Poland but also to other EU member states and Western countries.

<sup>9</sup> *Białoruś – przewodnik dla przedsiębiorców*, 6<sup>th</sup> ed., August 2006.

<sup>10</sup> Quote: *Białoruś – przewodnik dla przedsiębiorców*, 6<sup>th</sup> ed., August 2006.

<sup>11</sup> Data provided by the Polish Ministry of Economy.

**Table 2. The Polish imports from Belarus (USD 1000)**

<b>Commodity group</b>	<b>2000</b>	<b>2005</b>	<b>Change in %</b>
Food products	5,979	6,347	6
Mineral raw materials and fuels	42,378	626,468	1378
Chemical products	64,305	202,418	214
Industrial goods	28,821	112,173	289
Machinery and equipment	12,199	31,490	158
Other	0	617	
<b>Total imports</b>	<b>153,682</b>	<b>979,513</b>	<b>537</b>

Source: Polish Central Statistical Office, Foreign Trade Statistical Yearbooks 2001 and 2006.

The high concentration of the Belarusian exports in several commodity groups can be said to be an effect of the peculiar economic policy pursued by the Belarusian Government. One of the key objectives of its policies is to concentrate foreign trade in the hands of several state-owned giants, and supply products manufactured by domestic small and medium-sized firms to the internal market.

In contrast to the Belarusian exports to Poland, the Polish exports to Belarus are much more diversified. The top ten export commodities account for as little as 32% of Poland's total exports to Belarus<sup>12</sup>.

**Table 3. The Polish exports to Belarus (USD 1000)**

<b>Commodity group</b>	<b>2000</b>	<b>2005</b>	<b>Change in %</b>
Food products	34,669	131,452	279
Mineral raw materials and fuels	3,789	23,054	508
Chemicals	23,061	104,417	352
Industrial goods and various industrial products	87,362	249,988	186
Machinery and equipment	90,371	203,180	124
Other	4,550	9,983	119
<b>Total exports</b>	<b>243,802</b>	<b>722,074</b>	<b>196</b>

Source: Polish Central Statistical Office, Foreign Trade Statistical Yearbooks 2001 and 2006.

Despite Poland's EU membership in May 2004, trade development with Belarus is positive. The serious worsening of political relations between Warsaw and Minsk has not managed to weaken the upward trend.

<sup>12</sup> Information on Polish-Belarusian economic relations in 2005, study by the Trade and Investment Promotion Department, Polish Embassy in Minsk.



#### 4. Investment co-operation

Belarus is not an important destination for Polish capital expansion. One of the main reasons for that is the unfriendly investing climate in Belarus. The unfriendly investment climate is due to the Belarusian Government's policy, which consists in reinforcing the position of the state in the economy, discriminating in favour of domestic enterprises and setting up numerous barriers to large foreign investments. As a result of the unstable political situation and the political conflict between Belarus and Poland (and, in a broader context, between Belarus and the EU) foreign investors wishing to operate in Belarus cannot feel secure. The bad investing climate to a great extent undoes potential advantages the Belarusian market could offer to the Polish investors due to its geographical and cultural proximity, absorptive power of the market, links with the Russian market, etc.

In 2005, Poland was ranked the 11<sup>th</sup> among foreign investors in the Belarusian market; Polish investments amounted to USD 20 million and Poland had a 1%-share in total foreign investments<sup>13</sup>. The investment value is so low because large capital holders do not participate in foreign investments to Belarus. Currently, only small and medium-sized Polish enterprises are interested in Belarus. As of 1 January 2006, 430 companies with Polish capital were registered in Belarus, mainly in the City of Minsk, the Minsk district, and in the Brest district<sup>14</sup>. Their main areas of operation covered such sectors as trade (68 companies), construction industry (33 companies), wood industry (31 companies), car transport and car part production (30 companies), food industry (28 companies) and light industry (22 companies)<sup>15</sup>. The largest Polish investor in Belarus is the INCO-FOOD meat firm, which has invested approximately USD 33 million over several years of its operation.

So-called other investments, mainly commercial credits, amounted to USD 12 million. These other investments were the dominating type of Polish investments in Belarus in 2005. USD 7 million were invested as direct investments and no portfolio investments

---

<sup>13</sup> Data provided by the Belarusian Ministry of Economy, quote: *Information on Polish-Belarusian economic relations in 2005*, study by the Trade and Investment Promotion Department, Polish Embassy in Minsk.

<sup>14</sup> Polish investments in the Minsk and Brest districts are mainly linked to the free economic zones.

<sup>15</sup> Belarusian data as in *Białoruś – przewodnik dla przedsiębiorców*, 6<sup>th</sup> ed., August 2006, p. 176.

practically existed<sup>16</sup>. This reflects the peculiar condition of the Belarusian economy, which does not have effective market mechanisms.

No significant Belarusian investments have been registered in Poland so far. The launch of the Belarusian MTZ agricultural tractor assembly plant has been the largest Belarusian investment project in Poland until now. The enterprise sold 3500 tractors in 2005, which accounted for 25% of the total number of tractors sold in Poland.

## **5. Problems encountered by the Polish business in economic relations with Belarus**

Polish entrepreneurs encounter similar impediments in developing their activity in Belarus as entrepreneurs from other EU member states. One of the key barriers is the bad investing climate in Belarus. In international rankings, Belarus is determined as a country which is unfriendly to foreign investors. In 2006, the Index of Economic Freedom kept by the US Heritage Foundation determined Belarus as a country where foreign investment and financial transactions 'face hurdles'. On the scale from 1 (least limitations) to 5 (most limitations) Belarus was given 4 points<sup>17</sup>.

According to the Economist Intelligence Unit, the heavy fiscal levies, state interference and activities taken by the government with regard to private entrepreneurs create a climate which is unfavourable for doing business<sup>18</sup>. This effect is strengthened by heavy red-tape and corruption.

The five most serious barriers encountered by foreign entrepreneurs indicated by them in the World Bank surveys<sup>19</sup> include:

- Access to financing (including problems with getting credits and obtaining investment capital);
- Instable regulations and economic policy, and changing regulations without warning;

---

<sup>16</sup> Data provided by the Belarusian Ministry of Economy, quote: Information on Polish-Belarusian economic relations in 2005, study by the Trade and Investment Promotion Department, Polish Embassy in Minsk.

<sup>17</sup> 2006, Index of Economic Freedom, Belarus, [www.heritage.org](http://www.heritage.org)

<sup>18</sup> 2006, Index of Economic Freedom, Belarus, [www.heritage.org](http://www.heritage.org)

<sup>19</sup> Investment Climate Surveys, Draft Country Profile, Belarus 2005 Survey, World Bank.

- Heavy fiscal levies (and other quasi-fiscal charges, e.g. the obligation to financially support unprofitable state-owned enterprises and social base);
- Financing costs (high costs of credits, contract insurance, etc.); and
- A lack of macroeconomic stability in the country.

## **6. Barriers in Polish entrepreneurs' access to the Belarusian market**

A number of barriers which Polish entrepreneurs meet trying to access the Belarusian market are an effect of the Belarusian Government's economic policy aimed at making the country independent of co-operation with other countries. This is manifested by giving preferential treatment to domestic business in the internal market and developing local production to replace imports. This especially concerns the industrial plus agricultural and food sectors.

The Belarusian Government uses many tools, mainly a complex system of certification, licensing and limitations on imports of goods, to carry out their protectionist approach to local manufacturers. Other significant impediments include high customs duties and taxes, taxes on imported goods, protection procedures applied to imported goods and introducing protection instruments, limiting the freedom of buying imported goods as part of tenders, and decrees by the state administration and local governments limiting the freedom of buying goods by retail trade enterprises<sup>20</sup>.

Border crossing and transportation of commodities are also quite problematic. The procedures are complicate, time-consuming and often incomprehensible, and Belarusian authorities often impose very strict penalties, incommensurate to the offence (including confiscation of transported goods) even for small mistakes or inaccuracies during goods clearance. The problem of excessive penalties concerns also running business activity in Belarus in general.

Very expensive insurance of export contracts with Belarus have a detrimental effect on developing business activity in Belarus.

---

<sup>20</sup> *Białoruś – przewodnik dla przedsiębiorców*, 6<sup>th</sup> ed., August 2006, p. 178.

A barrier to private business activity can be posed by various quasi-fiscal solutions imposed on enterprises by the government. In fact, they consist in forcing private firms to finance so-called social projects implemented by the state. Other burdens of a similar type include financial support for extensive social facilities belonging to large firms (e.g. kindergartens and sanatoriums) and participation in enterprises organised by state or local authorities (e.g. public events, building infrastructure, etc.).

## **7. Other barriers**

Running a trade or investment activity in Belarus is rather difficult due to the high corruption level, which is an effect of the excessively complex bureaucratic system and state control.

Another problem for foreign entrepreneurs in Belarus is posed by cultural and mentality-related differences, and sometimes the insufficient ability of foreign firms to find their place in the local 'politico-business structure'. To run a business efficiently, it is vital to have informal support from the authorities. The legal system does not provide sufficient protection to entrepreneurs. The judiciary is to some extent receptive to informal external influence from the state authorities.

International political relations also affect the economic co-operation between Poland and Belarus. Since 2005, the Polish-Belarusian political relations have been bad. For this reason, state institutions in both countries have limited possibilities of developing economic co-operation between these two nations.

The insufficiently developed infrastructure (roads, transport, technologies used in industry, etc.) and a lack of well-qualified management staff are among the difficulties mentioned by Polish entrepreneurs working in Belarus<sup>21</sup>.

Other serious problems are the hard financial condition of many Belarusian enterprises and small incomes of people, which causes relatively low internal demand.

---

<sup>21</sup> Author's interviews with Polish entrepreneurs doing business in Belarus.

Imposing EU sanctions on the regime in Minsk may seriously affect the trade exchange between Belarus and the European Union, including Poland. On the 5<sup>th</sup> of December 2006, the EU Expert Committee decided by a majority of votes to exclude Belarus from the General System of Preferences (GSP). The Expert Committee's decision launches the procedure of depriving Belarus of GSP preferences. After it is approved by the Committee of Permanent Representatives of EU member states, Belarus will be given a half-year period to adopt adequate changes in the policy on trade unions and respecting employees' rights (which is the reason for launching the procedure to exclude Minsk from GSP). Otherwise, the trade sanctions will come into force.

The Belarusian exports to the EU area, which were covered by the GSP system, reached EUR 388 million in 2005. The main commodity groups exported by Belarus using lower custom duty rates included mineral products (19% of exports as part of GSP), textiles (13%), clothes (12%) and wood (10%)<sup>22</sup>. However, the GSP system did not extend to the key commodity groups exported by Belarus to the EU, oil (including oil products) and gas, the value of which reached EUR 1.9 billion in 2005<sup>23</sup>.

According to the Polish Economy Ministry, imposing sanctions on Belarus to deprive it of GSP preferences may inflict direct losses on Polish importers at USD 4 million annually<sup>24</sup>.

## **8. The advantages of Belarus as an economic partner of Poland**

The attractiveness of Belarus as an economic partner of Poland should be evaluated in keeping mind two options; 1) the present politico-economic system is maintained in Belarus, and 2) Belarus' political system undergoes changes (the likely perspective is five and more years) aimed at increasing market openness and economic liberalisation.

---

<sup>22</sup> *Trade unions worldwide urge EU to deny Belarus trade preferences*, 30.05.2006, <http://www.union-network.org>

<sup>23</sup> *EU's Plan to Eject Belarus From GSP May Deal Heavy Blow to Lukashenko Regime*, MosNews, 15.06.2006, [www.mosnews.com](http://www.mosnews.com)

<sup>24</sup> A statement by Mr. Marcin Korolec, Undersecretary of State at the Ministry of Economy at the 28<sup>th</sup> session of the Commission for European Union Affairs of the Polish Senate held on 30 May 2006. <http://www.senat.gov.pl/k6/kom/ksue/2006/028sue.htm>

Belarus' undeniable advantage for Poland is the proximity of this market. However, implementing investment projects is very difficult due to the present economic policy and the economic system existing in Belarus. The country gradually ceases to be attractive for Polish entrepreneurs as a market which enables access to the Russian market. Since Russia has curtailed trade preferences for Belarus and the conditions of doing business in Russia have improved in comparison with Belarus, Polish investors prefer to invest their money directly in Russia rather than in Belarus.

Currently, according to Polish businessmen<sup>25</sup>, one of the few attractive forms of business activity is implementing short-term projects aimed at gaining quick profits linked to trade exchange. The instability of the Belarusian market poses serious risk to long-term investments. This especially concerns small and medium-sized enterprises, which cannot afford such risks.

Polish entrepreneurs positively evaluate the solvency of their Belarusian partners, and the relatively efficient operation of courts, although courts' dependence on the government is a question mark.

Since the macroeconomic situation in Belarus has been improving (the growth of the GDP and the average wage, lowering inflation and high incomes generated by foreign trade), it can be expected that people's incomes will grow, which will translate into increasing demand in the Belarusian market. This has been proven by constantly growing turnovers in retail trade, which seems to be a promising prospect for the Polish exports.

Belarus has a large potential for developing economic co-operation in the future. It will be used, provided that market reforms are initiated and the economy is liberalised. In such a case, the activation of investment co-operation between Poland and Belarus will be possible. The Belarusian economy needs already now foreign investments to help it to modernise backward branches of industry and to enable transfer of modern technologies and know-how.

---

<sup>25</sup> Author's interviews with entrepreneurs doing business in Belarus.

## **9. Summary**

The current politico-economic situation seriously frustrates doing business in Belarus. However, even though Belarus is not a major economic partner for Poland now, it may become an attractive area for Polish businessmen in the future. Considering the lack of market reforms, domination of state ownership and the economic and technological backwardness, when proper political conditions come to existence, this country may provide a space for the expansion of Polish capital.

The higher gas prices, the change in the oil customs duty, and the rules of dividing the incomes related to this customs duty between Belarus and Russia are the key factors which may affect the economic co-operation between Poland and Belarus in the short term. This may in the first order cause raising the prices of goods exported by Belarus to Poland. The energy price rises may indirectly affect all the main Belarusian export goods, i.e. mineral raw materials (including oil and oil products), chemicals (including fertilisers) and industrial products.

Another factor which may curtail Polish-Belarusian trade exchange can be EU sanctions depriving Belarus of preferences as a part of the GSP customs duty rate system. This will cause increasing customs duties on such commodities imported by Poland from Belarus as mineral products, wood, textiles and clothes. If this is the case, Belarus in retaliation may impose higher customs duty rates on products imported from Poland.

In the long-term, the removal of Russian economic preferences and related worsening situation in the country (or even a crisis) will force Belarusian authorities to change its economic policy. Then Minsk could face the dilemma – strengthening the state economy by its liberal modernisation and openness to the world markets, or to adjust Belarus to the Russian political and economic system. It cannot be ruled out that then Minsk will try to compensate for the losses with the establishment of closer ties with the European market. The economic problems may also force the Belarusian Government to carry out reforms which on the one hand will alleviate the consequences of the crisis, and on the other will secure the economic position of the Belarusian nomenclature (e.g. by launching ownership reforms).

## **Poland-Belarus economic relations**

Henryk Borko and David Durkee

### **Contents**

1.	Bilateral trade	95
2.	Legal framework	97
3.	Industrial co-operation – investment	98
4.	Obstacles and perspectives for the co-operation	103
5.	Conclusions	106
	Bibliography	107
	Appendix	109



## **1. Bilateral trade**

Although policies, laws and regulations have changed, generally the structure of trade between Poland and Belarus has remained basically the same. Moreover, the volume of trade has grown. During 2002-2005, the Polish-Belarusian bilateral trade increased 2.5 times. According to both the Polish and the Belarusian data, the period from 2004 to 2005 was characterised as highly dynamic. During the aforementioned period, Belarus achieved a higher rate of exports. For the first time in 2004, the value of the total trade between the pair reached USD 1.3 billion. The value was over USD 500 million higher than in 2003. Moreover, it was 2.4 times greater than in 1997 year (USD 540 million) which was the record year during the period 1994-2002 (see Appendix: Table 1 and Table 2).

The trade between Poland and Belarus in 2005 continued to be characterised by high growth, however, the rate was not as high as in previous years. Both imports and exports expanded between the countries, although the Belarusian exports to Poland increased more quickly than the Belarusian imports from Poland. When compared with 2002, the total flow of trade grew 3-fold. In 2004, Poland's trade balance with Belarus became negative, which results from the purchase of more expensive Belarusian oil products. In 2005, Poland was one of the main trade partners for the Belarusian exports (according to Belarusian data) ranking the fifth place behind Russia, Holland, Great Britain, and the Ukraine. Poland was ahead of Germany, Lithuania and Latvia, the traditional trade partners for Belarus.<sup>1</sup> In the Belarusian imports, Poland holds the fourth place after Russia, Germany and the Ukraine.

For Poland, Belarus is an important, but not a major trade partner. Belarus occupies the 21<sup>st</sup> place among recipients of the Polish exports, accounting for 0.8% of Poland's total exports. Belarus ranks the 24<sup>th</sup> among the countries from which Poland imports commodities with a 1.0%-share. The Polish-Belarusian trade (according to Polish statistics) have reached a level of USD 1.7 billion (growing about 32%). The Polish exports total about USD 720 million (an increase of 27%), while imports from Belarus of USD 977

---

<sup>1</sup> It should be emphasised that the distance between Poland and the third ranked Great Britain has significantly decreased primarily due to the fast increase of exports from Belarus to Poland.

million (an increase of 36%). In affect, Poland has a negative trade balance with Belarus reaching USD 256 million.

According to data from the Ministry of Statistics and Analysis of the Republic of Belarus, the trade for 2005 totalled USD 1.4 billion (about a 19%-growth). The Belarusian exports to Poland were USD 847 million (approximately a 16%-increase), while the imports from Poland also rapidly grew to USD 579 million. The balance of trade was positive for Belarus and amounted to USD 268 million. The preliminary data for 2006 indicates the continued dynamic growth of trade between the two countries, and the bilateral trade may reach USD 1.7 billion. According to unofficial sources, the level might exceed with USD 2 billion – if informal trade from the grey sector is also included.

*Exports from Belarus to Poland:* Raw materials dominate the Belarusian exports to Poland. The five most important Belarusian export items accounted for 74% of the total, namely processed petroleum products, natural gas, potassium fertiliser, casein, and timber. In general, the exports to Poland increased in most categories with declines in automobile parts and cement. Moreover, there was a general lack of crude oil, which had previously been a major export item. However, the exports of liquefied natural gas (LNG) nearly doubled and processed petroleum products increased significantly as well. Thus, an overall net increase resulted in the exports from Belarus to Poland (see Appendix: Table 3).

*Exports from Poland to Belarus:* The Polish exports to Belarus lack a dominant group of goods. The three main export items account for only 18% of the total. Moreover, the first ten position account for 32%. In 2005, the exports of Polish coking coal, construction iron, and insulated wires/cables all increased. To a lesser a degree other exports, such as car vehicle accessories, fruits, paper products, meats, and cooking oil also saw a slight growth. However, some major exports also declined such as kerosene lamps and kinescopes (see Appendix: Table 4).

*Informal trade:* Due to the proximity of the two countries, an interesting phenomenon occurs that may be termed as informal trade. Basically goods flow in small amounts to be re-sold on the other side of the border. Interestingly, such informal trade may amount to

approximately 30% of the total trade between the two countries. Primarily tobacco and alcohol products flow from Belarus to Poland. Additionally, in the regions of Podlaski and Lubelski fuel mainly for agricultural use is an important product. The difference in prices tends to be 30%. The authorities tried to restrict this trade and especially the flow of fuels by implementing a more restrictive visa regime. Basically, people are allowed to cross the border by car once every three days. Since none of the borders, split a city such as the case of Cieszen which Poland shares with the Czech Republic, most of the traffic must be by some sort of motorised vehicle. However, since the car can cross the border more than once a day, drivers may be changed on a regular basis such that fuel continues to flow in this way.

In terms of informal trade flowing to Belarus, the most notable case is shopping tourism. Tourists from Belarus come to Poland to purchase luxury goods, such as perfumes, cosmetics and textiles before holidays and special occasions. These shopping tourists tend to be either more affluent people from Grodno or small traders. They mainly visit Auchan (the closest major hypermarket in the region) located 60 km from the border in Białystok.

## **2. Legal framework**

Economic relations between Poland and Belarus developed from legal regulations and treaties worked out in the years 1991 to 1996. During the period, the countries concluded around 60 conventions and agreements from the ministerial to national levels. The most important of which may be summarised as follows:

- Understanding concerning the organisation of transportation, signed on the March 30, 1992 in Minsk;
- Inter-governmental agreement regarding double taxation signed November 18, 1992 in Minsk;
- Inter-governmental agreement about the mutual supporting and protection of investment signed April 24, 1994 in Warsaw;
- Inter-governmental agreement about co-operation and assistance regarding customs; plus an agreement between the ministries of Farming and Agricultural Goods about co-operation in the spheres of quarantine and protection of plants from the 28<sup>th</sup> of September 1994, and an understanding about co-operation concerning the recognition research results, certificates and signs of conformity from the 27<sup>th</sup> of November 1995;

- Treaty of 'good neighbourhood and friendly co-operation' signed June 23, 1992 in Warsaw;
- Declaration by the president of the council of ministers from Poland and the Premier of Belarus about the development of economic co-operation January 21, 1995; and
- An understanding about co-operation in the areas of recognising research results, certification and signs of acceptance between the Polish Centre for Research and Certification and the Committee for Standards, Meteorology, and Certification of Belarus signed November 27, 1995.

As a part of the entry into the European Union, Poland had to declare a Polish-Belarusian agreement about economic co-operation and business. The bilateral agreement defined principles of commerce and was the basis for the operations of the Polish-Belarusian Department of Economic Co-operation. On April 30, 2004, the governments of Poland and Belarus signed a new agreement in Warsaw to enable the commission to continue working. Belarus was the first of the CIS countries, with which Poland reached such an agreement for co-operation according the terms required for membership in the European Union.

### **3. Industrial co-operation – investment**

In terms of industrial co-operation, the countries have had joint ventures, partnerships and even wholly-owned enterprises in the neighbour's territory. Historically, major co-operation between the two countries has been in the area of passenger services, i.e. the Polish airliner LOT, the Polish State Railways, the Polish Long-Distance Bus Service, and AUTOTRANSPORT. Such collaboration has also taken place in the area of construction business, such as BUDIMEX, BUDEKSPOL and the BUDPOL. Interestingly, no major Belarusian enterprises that had invested more than a million US dollars could be found in Poland. However, five Belarusian banks are present in Poland, while no major Polish banks are now in Belarus. Notably, there is one Polish enterprise that has the license to produce Belarusian MTZ<sup>2</sup> tractors.

According to the Belarusian data, the Polish investment reached USD 29 million in 2004

---

<sup>2</sup> In 2004, the firm sold approximately 3000 tractors, and had a 25%-share of the market in Poland.

and accounted for just 2% of the total foreign investment in Belarus. In comparison with 2003, the relative increase was about USD 9 million, or 45%. The incremental growth in joint venture participation was only about half of a percentage point.

In 2004, Poland ranked the 11<sup>th</sup> as a source of foreign investment to Belarus behind countries, such as Switzerland, Russia, Germany, Great Britain, USA, Austria, Holland, Latvia, Cyprus and the Virgin Islands. Table 5 shows the Polish investments to Belarus for 2004 (see also Appendix).

The following shows the Polish investments in Belarus for 2004.

- 1) Direct investments: USD 11 million (USD 9.0 million in 2003)
  - investments in fixed assets: USD 5 million,
  - credit given by Polish shareholders: USD 1 million,
  - remaining direct: USD 5 million,
- 2) Round trip investments: USD 4500 USD
- 3) Remaining investments: USD 18 million

As of February 2006, the investments from Poland to Belarus totalled USD 36 million.

One should note that in 2005, the amount of Polish investment decreased from USD 29 million to USD 20 million. Thus, Poland also slipped in the ranking to the 11<sup>th</sup> place. Its share of total investment dropped from 1.9% in 2004 to just 1.1% in 2005, one can question whether Polish capital plays any significant role in Belarus.

*Significance of the Polish investment in Belarus:* Poles lead in the total number of joint ventures. Polish capital tends to be involved in small and medium-sized enterprises (SMEs) connected with trade and production. Firms with Polish capital employ 10,200 people with 3200 of them working in the free economic zones (FEZs).

According to available data, 253 firms with Polish capital operate in Belarus. The highest number of such firms was registered in January 2006. They may be found in many different sectors; 68 in trade, 33 in building materials, 31 in wood, 30 in the production of automobile parts, 28 in consumer goods, and 22 in pharmaceuticals. In the FEZs of

Belarus, 46 firms operate with Polish capital.

*The regional division of the Polish foreign direct investment in Belarus:* 31% of the Polish-owned companies operate in or around Minsk (24% actually in the City of Minsk). Another 30% operate in the surroundings of Brest, with 7% in or near Grodno – both of the aforementioned regions have a free economic zone. Thus, when calculated together those areas represent 93% of the investment. The remaining Polish investments may be found in three other regions: 3% in Gomel, 2% in Vitebsk, and 2% in Mohilev.

In the free economic zones of Belarus, 46 firms operate with Polish capital. A prime example would be INKO Foods, which operates in the FEZ Brest. The firm may be considered a trading company involved in the consumer goods, the production of building materials, dietary supplements, the piecing of clothing and food. INKO Foods is the largest Polish investment in Belarus. Other notable firms would be ŚNIEŻKA in paints, and ATLAS in adhesives.

Since small and medium-sized enterprises typify the Polish investments, it is not surprising that most have been developed through contacts, meetings and conferences often organised by the Polish-Belarusian Chamber of Commerce. Since 1995 a Polish origin Chamber of Commerce in Grodno, actively promotes the Polish goods on the Belarusian market through fairs and other promotional events.

In general, much complementarity exists for the two sides to cooperate. Physical and cultural proximity play a major role. From Warsaw to Terespol is barely 200 km, and to Minsk further 350km. Brest, Grodno and Minsk can be reached by rail, car and bus, Minsk additionally by plane. Although physically close, surprisingly Polish entrepreneurs know little about Belarus. During initial visits, Polish entrepreneurs are often surprised to see good roads, and shops full of goods. Many have noted that food prices tend to be higher than in Poland, but light consumer goods tend to have lower prices although quality-wise be either equal or better than those found in Poland. Generally, the Polish entrepreneurs see Belarus as a European country, and its society - with similar culture and mentality - is friendly to Poles.

However, these initial impressions are confronted with a reality: the poor financial situation of the Belarusian enterprises; heavy administration, the continued presence of central planning, and a complicated legal system regulates everything. Above all, the Polish-Belarusian border is poorly prepared for an increasing volume of traffic between the two countries.

*Some insights into the co-operation:* According to the Polish-Belarusian Chamber of Commerce, the proximity of the Polish market and the longer term perspective of gaining entry to Western markets via Poland make co-operation with the Polish investors attractive for the Belarusian firms. In addition, Poland offers a large market. Hence, co-operation can increase the chance for the Belarusian exports.

Equally, for the Polish entrepreneurs looking east, Belarus offers a gateway. For goods produced in Belarus, the Russian market is completely open. Although, this is not the only reason or not even the main reason to invest in Belarus, one should note that the price for raw materials in Belarus can be as high as in Russia, or even higher. Such a situation occurred in the production of consumer goods. Hence, some investments went directly to Russia.

Moreover, Belarus' favourable tax incentives for foreign investors attract investors from Poland. Especially favourable conditions exist in two free economic zones located close to Grodno and Brest. Both the FEZs are close to the Polish-Belarusian border.

*Cross-border co-operation:* Polish-Belarusian consultations on the ministerial level (deputy ministers of economy) take place with regard to energy security. The consultations are mainly centred on the construction of the heat and power station in Brest with the participation of Polish investors, which ultimately would be powered by Polish coal. As part of the transborder co-operation, the road border crossing Bobrowniki-Bierestowica was completed and made available for the passenger traffic. On the Polish-Belarusian border, the modernisation of the Kuźnica Białostocka-Bruzgi border crossing was the most important and largest investment. Its main aim was the provision of efficient inspection of all kinds of vehicles.

On July 15, 2004, a new bridge of 275 m across the Bug River became operational. It was built at the Polish-Belarusian border crossing in Kukuryki as an extension to the future A2 motorway Berlin-Warsaw- East Polish Border, which should transform into M1 motorway towards Minsk and Moscow. In the framework of transborder co-operation, the Belarusian side prepared technical specifications, and in-roads to the bridge were constructed by both sides respectively. Vehicles up to 50 tonnes are allowed to enter the bridge. The total cost of this investment amounted to over USD 5 million.

Poland and Belarus have agreed to open five new border crossings. They are planned in Koterka, Białowieża, Jałówka, Chworościany and Lipszczany. Moreover, the Belarusian side declared the modernisation of Augustów Channel (June 2006) to make the Polish-Belarusian border more open.

New crossings will be servicing mostly local traffic, i.e. the Poles and the Belarusians. Only Chworościany and Lipszczany will accept international traffic, including third countries. Other crossings will remain basically unchanged. After the modernisation and the extension of the Kuźnica Białostocka crossing, the Polish side advocates the refurbishment of Połoece. The Belarusian partners claim to have no funding for such an investment.

Planned road border crossings and their assigned functionality:

- Koterka, Jałówka and Białowieża - local traffic;
- Chworościany (Nowy Dwór municipality) - international personal and goods traffic up to 3.5 tonnes; and
- Lipszczany - international tourist traffic.

*Transborder co-operation – Euroregions:* The idea of creating a transborder region 'Green lungs of Europe' originated from the Polish program 'Green lungs of Poland' encompassing the north-east part of Poland, i.e. the area of former provinces of Białystok, Łomża, Olsztyn, Ostrołęka and Suwałki and partly Ciechanów, Siedlce and Toruń. The implementation of the program results from the agreement concluded by the regional administration (voivodships), regional self-governments (governors) and the National Foundation for Environmental Protection.

Poland and Belarus participate in a transborder association named the Niemen



Euroregion. It was formed in June 1997 and in consecutive years was extended. At present, the total area of the Niemen Euroregion amounts to 89,085 sq km, and is inhabited by close to 5 million people.

The framework for co-operation of the Niemen Euroregion is aimed at overcoming the mutual animosity and prejudice among the inhabitants of those border regions, promoting democracy, combating negatives effects of the peripheral location and isolation, stimulating economic development, as well as generally raising the standard of living for the inhabitants and their prompt integration with Europe while preserving their independence.

More recently another Euroregion has been developed on the Polish-Belarusian border - the Białowieska Forest Euroregion formed on the basis of an agreement signed on May 25, 2002 in Hajnówka. The co-operation aims at supporting the economic development, bringing inhabitants and the institution from both sides of the borders closer together as well as creating conditions for better co-operation of authorities and self-government bodies of both states. Common action is undertaken in the scope of the region:

- environmental protection, and rational usage of natural resources;
- ecological and culture tourism;
- social-economic, cultural and scientific-educational co-operation;
- bringing together people of both states; and
- the preservation of the unique character of Białowieska Forest.

#### **4. Obstacles and perspectives for the co-operation**

*Obstacles:* Decisions taken in recent years by the Belarusian side have led to major limits on the imports of some Polish goods; mainly agriculture and foodstuffs, and have thus inhibited trade. From this perspective, Belarus appears to be concentrating on a strategy of import substitution. Moreover, the strategy seems to take precedence over programmes for the promotion of exports. Clearly, the political objective appears to target to Belarus' economic independence and not to integration into the world economy. The primary objective or emphasis of these politics appears to be above all centred on the protection of domestic industry and the agricultural sector.

*Polish imports from Belarus:* The analysis of the Polish imports from Belarus reveals that the Belarusian producers tend to be only the largest industrial plants (refineries, factories of synthetic fibres, nitric factories, the conglomerate of potassium, cement plants, the factory of agricultural tractors, the lorry factory, and the factory of tyres). The trade with small and medium-sized enterprises (SMEs) are not detectable, which raises an important question – why. In part, it may be attributed to a lack of possibilities for the SMEs to promote their products beyond the borders.

*Polish exports to Belarus:* The competitiveness of the Polish goods in the Belarusian market is handicapped when compared with the goods from the Russian Federation. First, there is tax and especially the VAT of 18%. Then, there are non-tariff barriers, such as licensing and the obligatory registration of certain goods, as well as the certification. The most significant barriers to the Belarusian market experienced by Poles tend not to be the formal ones, but the rather the bureaucratic ones. This requires additional work to be undertaken by the Polish entrepreneurs; however, the obstacles may be overcome. Furthermore, there is a general lack of reliable information about the Belarus market. The characteristics of risk averseness and the flexibility of the SMEs may help explain why smaller Polish firms tend to be present rather than larger enterprises.

*Poland's EU Accession:* Poland's accession to the European Union affected the conditions of imports from Belarus in a slightly positive way. According to the Polish data, 37% of the import tariffs were not affected. However, 36% decreased while only 27% increased, thus yielding the slightly positive offset. The EU also has a quota for textiles and clothing. Moreover, anti-dumping measures affect goods from Belarus.

Belarus limits foreign trade as well, which has an adverse effect on the Polish exports. Both customs duties and other protective measures may be cited. Most recently, there was a ban on the imports of poultry due to bird flu. The main problem the Polish exporters face is the complicate and expensive certification procedures. Moreover, high seasonal customs duties limit the Polish exports of onions, cabbage, carrots, beets, and potatoes as well as potato flour. Increasing duties also have affected paints, varnishes, electric lamps, coffee pots, drills, vacuum cleaners, and wallpaper.

*Perspectives:* There are good possibilities for furthering co-operation between Belarus and Poland. Some possible chances for collaboration may open in the following fields: financing, transportation, promotion, farming, and energy. On account of the poor financial situation of some Belarusian enterprises, producers offering equipment, investment and even credit will be important. They can help the cash flow situation. Instruments enabling transactions of this type exist: KUKE insurance policies the PLC and interbank credit lines. However, a greater availability, and even some along the lines of small credits could aid in fostering the SMEs' exports from Belarus. A good chance also exists for the expansion of transport services. In general, an asymmetry exists in granting permits for haulers. One way to solve this problem is to decrease the number of permits or to have cross-border firms.

The Polish producers need to change their strategy and focus on co-operation in farm goods, medicines, and industrial products. In addition, more emphasis should be given on sales of manufactured products to the Russian market. To make the leap, more attention will need to be given to the quality of the Polish products, as well as their promotion and advertisement.

In the longer term, one must also question the vulnerability of the Belarusian economy. Since the economy tends to be very energy intensive and dependent upon the energy imports, rapid rises in the energy prices could be extremely detrimental for Belarus if the economic base remains undiversified and unconnected. By developing miniature economies of scale based upon bilateral trade with neighbours such as Poland, and other economic activities. such as eco-tourism, the risk might be significantly mitigated. The longer such an engagement remains postponed, the greater the risk. Therefore, Belarus, Poland and the whole EU should realise that it is of their best interest to begin whatever initiatives possible.

## 5. Conclusions

The primary findings of this study may be summarised as follows:

1. The lack of a transparency greatly impedes the possible flow of goods, and probably much to the detriment of Belarus. Should the system be more transparent, some Belarusian goods might find their place in the greater European market.
2. The engagement with Belarus happens on too low administrative level.
3. The genuine border traffic between Poland and Belarus is modest, as most of the traffic tends to be of a transit nature either destined further to east or further to west.
4. In contrast to Ukraine, the visa regime causes both Poles and Belarusians to pay for visas, thus inhibiting the movement of people.
5. The chambers of commerce are instrumental in fostering the co-operation.
6. Additional capacity building is needed on the borders.
7. While the EU has a good neighbourhood policy that generally notes Belarus, no details are given how the EU countries, and especially Poland, should engage.
8. Euroregions are possible, but they will need additional financing from the EU.
9. Although small in monetary terms, the Polish FDI plays an important role in Belarus providing the transfer of technology and know-how.

The co-operation between Belarus and Poland has great potential to develop. Some areas such as eco-tourism or health vacations will arise, if the borders are open.

Since 1991, the economic and business co-operation between Poland and Belarus has generally developed towards a positive direction. However, while the countries share a common boarder, co-operation is not as transparent as it could be. Rather co-operation tends to be a natural result of the proximity inhibited by rules and regulations. The analysis of the bilateral trade and investment has demonstrated that Poles play a significant role due to the number of investments (i.e. number of companies), even if the total amount invested is not particularly high. Notably, while the two countries have expanded their formal co-operation into other spheres including the Euroregions, there are still obstacles to be overcome in improving the co-operation.

*The following recommendations can be proposed:* Belarus should decrease the amount of bureaucracy. Poland can be a very good neighbour, and can help Belarus upgrade the country's knowledge and processes, which may improve the Belarusian exports. However, reforms are needed. Only by making the system more transparent, significant positive change may occur.

Poland should engage more constructively with its neighbour. An important area to consider for co-operation would be the advancement of local traffic. In building capacity near the borders, some smaller projects could be realised. These areas would provide direct benefits to Poland and Belarus. Much of the trade between the countries will be conducted by smaller firms, thus the quality of engagement should be considered in terms of frequency rather than purely in terms of monetary measures.

The European Union should consider that the Belarusian economy is very vulnerable to external shocks, such as the rapid rising of natural gas prices. Hence, helping to build capacity and other economic networks between Poland and Belarus is very much in its best interests. By helping to develop networks and trade between the two countries, the EU can assist in providing a stabilising effect for Belarus that will insure that it does not fall prone to collapse or disintegration, if energy prices rapidly increase. Should the latter alternative occur, it could have detrimental consequences for the EU. Thus, the EU should concentrate on developing policies that make the border more accessible for the local traffic and the people living in the border regions, in order to develop local trade.

## **Bibliography**

- Belarus w liczbach 2003, Ministerstwo Statystyki i Analizy RB, Mińsk 2003.
- Borko H., Belarus jako gospodarczy partner Polski, w: Gazeta Finansowa, marzec 2002 [a].
- Borko H., Paneuropean economic co-operation and its implications for the crossborder economic co-operation of Poland and Ukraine and Belarus, 10<sup>th</sup> General Conference of EADI, 19-21 September 2002, Ljubljana, Slovenia [b].
- Borko H., Polska-Belarus: dlaczego jest aż tak źle? Gazeta Finansowa Nr 50/grudzień 2003 [c].
- Borko H., Możliwości podejmowania działalności gospodarczej na Białorusi, UNIDO i Wyższa Szkoła Humanistyczno-Ekonomiczna we Włocławku, Włocławek 26.06.2004 r. (materiał powielony) [d].
- Brixiova Z., Economic Transition in Belarus: Achievements and Challenges, IMF, 11.07.2004
- Business Environment in Belarus 2005, International Finance Corporation World Bank Group 2006
- Clement H, Stosunki gospodarcze nowych sąsiadów z Unią Europejską na przykładzie Białorusi i Ukrainy, Instytut Europy Wschodniej, Monachium 2004.
- Comiesięczna analiza gospodarki Białorusi, Nr 1-12/2005 r. IPM, Mińsk 2005.
- Ekonomika Białorusi. Tendencje, oceny, prognozy, I i II kwartał 2006, CASE/IPM, Mińsk 2006.
- J. Urbanowska, H. Borko, J. Pieregud, Belarus 2005s. Przewodnik dla przedsiębiorców, UNIDO, Warszawa 2005.
- J. Urbanowska, H. Borko, J. Pieregud Belarus 2006. Przewodnik dla przedsiębiorców, UNIDO, Warszawa 2006.
- Kodeks inwestycyjny Republiki Belarus 2001.
- [MSiA RB], Materiały informacyjne Ministerstwa Statystyki i Analiz RB, Mińsk 2006.

Nowa Europa – raport z transformacji, Forum Ekonomiczne, Instytut Wschodni, Krynica, wrzesień 2006

Republic of Belarus in figures, Short Statistical book, Ministry of Statistics and Analysis of the Republic of Belarus, Minsk 2004.

Republic of Belarus: 2005 Article IV Consultation-Staff Report; Public Information Notice on the Executive Board Discussion; and Statements by the Executive Director for the Republic of Belarus, Country Report No. 05/214, IMF 2005 ([www.imf.org](http://www.imf.org))

Republic of Belarus: Financial System Stability Assessment, including Reports on the Observance of Standards and Codes on the following topics: Banking Supervision, Payment Systems, and Anti-Money Laundering and Combating the Financing of Terrorism. Country Report No. 05/216, IMF 2005 ([www.imf.org](http://www.imf.org))

Republic of Belarus: Selected Issues, Country Report No. 05/217, IMF 2005 ([www.imf.org](http://www.imf.org))

Republic of Belarus: Statistical Appendix, Country Report No. 05/218, IMF 2005 ([www.imf.org](http://www.imf.org))

Republika Belarus w liczbach 2004, Ministerstwo Statystyki i Analizy RB, Mińsk 2004.

Starzyk K (red.), Gospodarcze sąsiedztwo Polski, Wydawnictwo Naukowe SEMPER, Warszawa 2005 [a].

Starzyk K. (koordynacja naukowa), Zagraniczne inwestycje bezpośrednie w gospodarkach w procesie transformacji, sympozjum naukowe SGH, Warszawa 2005 [b].

Współpraca gospodarcza Polska – Belarus, Departament Międzynarodowej Współpracy Dwustronnej, MG, kwiecień 2006.

## Appendix

**Table 1. Trade between Poland and Belarus 1995-2005 (Polish data - USD million)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Turnover	479	529	540	436	399	398	421	487	781	1264	1697
Exports	241	272	319	266	233	244	276	260	396	565	720
Imports	238	257	221	170	166	154	145	227	386	699	977
Balance	3	15	98	96	67	90	130	33	9	-133	-256

Source: Centrum Informacji Handlu Zagranicznego, Ministerstwo Gospodarki RP.

**Table 2. Trade between Belarus and Poland 1996-2005 (Belarusian data - USD million)**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Turnover	533	496	468	421	493	450	495	783	1204	1426
Exports	338	246	185	208	277	248	273	434	729	847
Imports	195	250	283	213	216	202	222	349	475	579
Balance	143	-4	-98	-4	61	46	52	86	254	268

Source: według danych Ministerstwa Statystyki i Analiz RB – May 2006,

**Table 3. The Belarusian exports to Poland (USD 1000)**

Code	Item	2004	2005	05/04 (%)
2710	Different than raw oils of petroleum	298,919.6	380,274.2	127.2
2711	Natural gas	57,560.5	114,812.8	199.4
3104	Potassium fertilisers	72,303.7	78,488.1	108.5
3501	Kazeina	25,146.1	29,324.8	116.6
4403	Raw also coarse worked wood	8,276.0	22,164.2	267.8
2716	Electric energy	17,357.2	20,561.2	118.4
7207	Parts from non-alloy steel	15,181.5	18,429.7	121.4
8544	Insulated wire, cables, electric wires	7,267.4	14,781.4	203.4
8701	Tractors	326.1	12,893.1	3,953.7
7312	Twisted-pair cables, ropes, cables, steel tapes	9,476.3	11,666.7	123.1
2709	Oils of petroleum, raw	69,430.6	-	-
8708	Parts and accessories into motor vehicles	19,077.5	2,436.2	0.1
2523	Aluminium, anhydrite Portland cement	12,890.1	9,728.4	75.5
2905	Acyclic alcohol and their consequences	9,500.1	9,677.1	101.8

Source: the Ministry of Statistics and Analyses of the Republic of Belarus - May 2006.

**Table 4. The Belarusian imports from Poland (USD 1000)**

Code	Item	2004	2005	05/04 (%)
0203	Fresh, chilled or frozen pork	42,659.0	47,878.6	112.2
4410	Chipboards or similar	31,937.5	34,508.5	108.0
8540	Valves, picture tubes	31,479.6	19,569.6	62.1
4818	Toilet paper, cellulose wadding, handkerchiefs	11,614.3	16,172.8	139.2
8302	Covers, metal fittings, metal to furniture, doors, stairs,	9,111.9	13,860.2	152.1
0808	Apples, fresh pears	9,321.7	13,207.0	141.6
6806	Cinder, rock, mineral wool	9,106.1	10,172.3	111.7
8708	Parts and accessories for motor vehicles	5,486.5	9,831.5	179.2
8544	Insulated wire, cables and different electric wires	4,609.7	9,802.8	212.6
7308	Structural steel	4,192.3	9,601.6	229.0
2704	Coke, semi-coke	3,363.7	9,399.5	279.4
3004	Compound cures in containers for retail sales	7,967.4	9,322.4	117.0
0209	Pork or poultry fat, without the meat	6,451.9	8,780.6	136.1
4411	Hardboards	9,312.2	8,587.1	92.2

Source: the Ministry of Statistics and RB Analyses

**Table 5. Polish investments in Belarus (USD 1000)**

	2003		2004		2005	
	Value	Share	Value	Share	Value	Share
<b>Total foreign inv.</b>	<b>1 306 457.0</b>	<b>100%</b>	<b>1 517 381.4</b>	<b>100%</b>	<b>1 816 169.1</b>	<b>100%</b>
Polish share	19 919.3	1.5%	28 846.3	1.9%	19 668.2	1.1%
<b>Direct investments</b>	<b>674 514.0</b>	<b>51.6%</b>	<b>859 176.3</b>	<b>56.7%</b>	<b>451 303.1</b>	<b>24.9%</b>
Polish share	8 826.2	1.3%	11 022.7	1.3%	7 315.5	1.6%
<b>Round tripping</b>	<b>637.1</b>	<b>0.05%</b>	<b>391.3</b>	<b>0.03%</b>	<b>246.9</b>	<b>0.01</b>
<b>Remaining</b>	<b>631 305.9</b>	<b>48.3%</b>	<b>657 813.8</b>	<b>43.4%</b>	<b>1 364 619.1</b>	<b>75.1%</b>
Polish share	11 093.1	1.8%	17 819.1	2.7%	12 352.7	0.9%
<b>Number of foreign-owned firms as of January 2005</b>						
Total of companies with the participation of foreign capital					3457	
Joint ventures					1841	
Companies with 100% participation of foreign capital					1616	
Companies with the participation of Polish capital					350	
Joint ventures with the participation of Polish capital					223	
Companies with 100% participation of Polish capital					127	

Source: Ministry of the Economy RB May 2006.



## **Lights and shades of Russia-Belarus economic relations**

Vladimir Sherov

### **Contents**

1.	General characteristics of the Russia-Belarus relations: Their role for two countries	112
2.	The legal framework of economic and political relations and its evolution on federal and regional levels	113
3.	Co-operative programmes and their effectiveness	115
4.	Trade dynamics	116
5.	Oil and natural gas trade and its role in the mutual relations	120
6.	Mutual investments	124
7.	Trade in services	125
8.	Regional aspects of economic relations	126
9.	Migration and education exchange: Problems of migrants	126
10.	Foreseeable impact of Russia's accession to the WTO on the Russia-Belarus relations	128
11.	Conclusions	129
	References	131

## 1. General characteristics of the Russia-Belarus relations: Their role for two countries

Belarus and Russia have strong economic, political and cultural links, important for both countries. It goes without saying that this relationship is more important for Belarus, due to a different size of these two economies (see Table 1), but one should not neglect the other side: Belarus is the closest partner and ally for Russia as well. The background of such a strong relationship lies neighbourhood, long tradition of living in one state and common language. The majority of the Belarusians speaks the Russian language better than the Belarusian one<sup>1</sup>. Culture is also very close, as well as the mentality of the Russians and the Belarusians. It would not be a mistake to conclude that people of two countries sympathise with each other.

**Table 1. Population and GDP of Belarus and Russia at 2005**

	Population, million (2006)	GDP, USD billion		GDP per capita, USD	GDP growth, %
		Official exchange rate	Measured at PPP		
Belarus	10.2	27	73	7 100	9.2
Russia	142.9	740	1584	11 000	6.4

Source: World Factbook, 2006.

In addition to all the aforementioned factors, there is still at least another significant reason for a particularly close relationship between two countries, i.e. the negative image of the Belarusian leader A. Lukashenka in the West, resulting from his authoritarian governance and constituting some limits for the development of fruitful relations between Belarus and European countries and the USA. Another factor is the level of competitiveness of the Belarusian and Russian industry, which lag behind international standards, but fit each other. And the last, but not the least is the mutual dependence in the fuel sector.

---

<sup>1</sup> According to sociological studies, 81% of the Belarus population is Belarusians by ethnic origin, but only 8% of population uses the Belarusian language in everyday communication. 52% uses the Russian language, while 16% are using both languages, and 23% - a mix of the two languages (<http://www.iiseps.org>).

The first decade of the transition period in post-Soviet countries was marked by the divergence from the Soviet system as well as from each other's systems. Russia and Belarus moved in the same direction during the first 2-3 years of the market transformation, in 1992-94. However, after the presidential elections of 1994, when Lukashenka won on the wave of his anti-corruption and anti-privatisation election campaign, the mutual divergence started due to the interruption of many economic reforms in Belarus. A slow pace of transition and the heavy burden of the systemic disadvantages of the bureaucratic economy constitute obstacles for the integration of these two economies.

## **2. The legal framework of economic and political relations and its evolution on federal and regional levels**

Belarus and Russia have been independent states since the break-up of the USSR in December 1991. In the very beginning of the separate existence, efforts had been made to escape from imposing barriers in mutual trade. In November 1992, the Free Trade Agreement (FTA) was signed. In January 1995, a protocol on the implementation of this FTA without exemptions was signed as well as the Agreement on the Customs Union. In May 1995, the border pole was symbolically dug out by the prime-ministers of the two countries.

In April 1996, the Treaty on a Community of Belarus and Russia was signed, to be followed by the Treaty on a Union of Belarus and Russia of April 1997, the Declaration on Further Uniting of Belarus and Russia in December 1998, and the Treaty on Creation of a Union State of Belarus and Russia in December 1999 (came into force in January, 2000). A substantial similarity of the four aforementioned documents suggests that they largely represented the elements of a political game played by the Belarusian president, who was repeatedly expressing brotherhood feelings towards Russia and its president Boris Yeltsin to get additional privileges in economic relations. Lukashenka tried to imitate integration rather than take the last step into the political unification, i.e. Lukashenka used a kind of asymptotic approaching tactics.

The Treaty of Creation of a Union State implied consecutive convergence of legal systems and creation of three unified spaces: 1) defence, 2) humanitarian issues, and 3) the economy. However constitutions and obligations under international treaties remained untouched. The objectives of the treaty are far from having been reached, but the critics of the integration cannot neglect the effect of the Treaty on equal rights of citizens, signed in 1998. This treaty grants to the Belarusian citizens equal rights with the Russian citizens in both states, including right to live and work without passing additional formalities (necessary for foreigners) together with a free access to education, medical care and other public services provided by the state. Other important documents of 1998 were the Agreement on the Creation of Equal Business Environment (conditions of entrepreneurship) and the Agreement on the Creation of the Equal Conditions in the Sphere of Prices and Tariffs Policy. Their implementation, though, was very limited.

The goal of the introduction of common currency had been mentioned numerous times since the beginning of the 1990s. In ten years, the process of technical preparation finally started: Central banks of two countries signed a plan of co-ordinated activity for 2001-2005. In spite of that, one of the core issues remained unsettled; the Belarusian side was insisting on the co-existence of two emission centres, while the Russian side neglected sharing of the prerogative. In fact, Russia assumed that Belarus would simply abandon its own currency and adopt the Russian rouble. However, even this option would have its negative implications for Russia. In particular, Russia would need to finance the deficit of the Belarusian budget, burdened by social programmes and subsidised non-profitable state enterprises. Nevertheless, the project as whole is considered affordable for Russia thanks to envisaged political results. But Lukashenka disagreed, demonstrating once again, that all the previous activity in this field was directed on an imitation of the integration for the sake of the temporary privileges and preferences from Russia.

The Union State has several administrative bodies, with a very limited competence. They include the Parliamentary Meeting, the Supreme State Council, the Executive Secretary, and the Union Council of Ministers. During the first five years of its work (since 2000), the Supreme State Council considered 84 issues and adopted relevant decisions; while the Union Council of Ministers worked on 400 issues. According to Vassily Sholodonov, the Council's representative to Minsk, about 90% of all decisions, adopted by those bodies,

have been implemented – a very good indicator, especially if compared with the situation in the CIS, where the majority of the decisions have been left unfulfilled<sup>2</sup>.

The common budget of the Union State is adopted annually by the Parliamentary Meeting of the Union State. Its estimate for 2007 is 3782 million roubles (USD 143 million), which is equivalent to 0.02% of the total GDP of both countries or 0.5% of Belarus' GDP. Two thirds of the finance comes from the Russian budget, and the remaining third from the Belarusian one. The administrative expenditures amount to 7% of the total expenditures. Most of the financial resources is used for financing of joint programmes and projects in R&D, industry and infrastructure. The public entities prevail among the recipients and clients but the possibility of private companies' participation is provisioned as well.

### **3. Co-operative programmes and their effectiveness**

Co-operative programmes in specific industrial sectors and R&D have become an important part of the mutual relationships between Belarus and Russia. They are co-ordinated on the government level and partially funded from the budget of the Union State. The number of the joint programmes under the implementation in 2006 was 40, 8 of them were focused on industry. According to Pavel Borodin, the Executive Secretary of the Union of Belarus and Russia, joint projects have helped to preserve or to create about 3 million jobs in two countries.

For instance, 33 research bureaus participate in the development of the equipment for production of special synthetic fibres, and 10,000 new workplaces may emerge thanks to its implementation. New fibres are unique in terms of their set of parameters, including heat-resistance and strength. Hence, they can be used for manufacturing special protecting dress for hot works and for the military. Other fibres are excellent for making blood filters for leukocytes filtering.

Another project resulted in the development of the SKIF supercomputer, which joined the group of world top 100 of high-capacity computers. The EU offered USD 300,000 for

---

<sup>2</sup> [www.regnum.ru/news/632235.html](http://www.regnum.ru/news/632235.html). 28.04.2006.

incorporating the SKIF into the European network of supercomputers, but the stronger 1 GB per second line is necessary to be built first.

Development of medicines from milk-derived proteins of transgenic animals is the essence of yet another joint project which was completed in 2006<sup>3</sup>.

#### **4. Trade dynamics**

Russia holds an unchallenged first position as Belarus' trade partner, and Belarus remains a very important trade partner of Russia as well. During most of the post-Soviet period, the Belarusian share in the Russian foreign trade was approximately equal to that of Ukraine, though Ukraine is nearly 5 times more populated than Belarus, and has a similar level of the industrial development.

Nevertheless, the Russia-Belarus trade relations have not been absolutely stable during 15 years of separate life. Russia's share in the Belarusian exports grew in 1995-1998 from 45% to 60%, but later on it started to decrease, falling to 36% in 2005. At the same period, Belarus' import dependence on Russia remained high, fluctuating from 53% to 68%, following changes in energy prices (see Table 2).

**Table 2. Russia's share in the Belarusian foreign trade, %**

	<b>1995</b>	<b>1998</b>	<b>2001</b>	<b>2004</b>	<b>2005</b>
Russia's share in the Belarusian Foreign trade	49.7	59.4	59.7	58.5	48.4
Exports to Russia	45.5	65.2	53.2	47.1	35.8
Imports from Russia	53.3	54.6	65.6	68.0	60.6

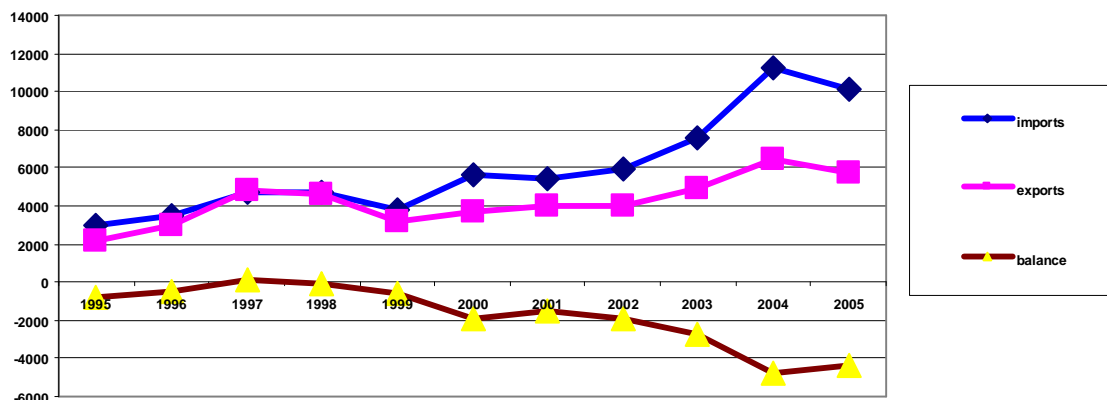
Source: [www.belstat.gov.by](http://www.belstat.gov.by)

The mutual trade in goods grew during 1995-2005 period, except for years 1995 and 2005. Belarus has a negative balance of trade with Russia, and its scale aggravated during 2000-04, reaching USD 4.7 billion (see Chart 1).

---

<sup>3</sup> Rossiyskaya gazeta, 27 December 2006.

**Chart 1. The Belarus-Russia trade in goods, 1995-2005, USD million**

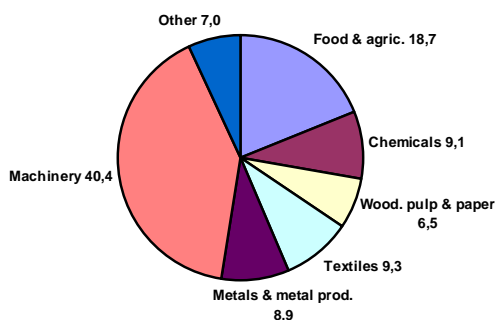


Calculations based on [www.stat.gov.by](http://www.stat.gov.by) data.

By 2005, the position of Belarus in the geographical breakdown of Russia's foreign trade decreased to 4% of the Russian exports (6<sup>th</sup> rank) and 6% of the Russian imports (4<sup>th</sup> rank). It reflects the trade diversification efforts of Belarus. The trade with the EU is growing faster than with the Russian Federation.

The manufactured goods dominate in the exports of Belarus (see Chart 2). The machinery covers 40% of all the exports; heavy trucks for quarrying, tractors, gas-stoves and refrigerators being among the main items. Exported chemicals include potash fertilisers and synthetic fibres. Metal products, furniture, television sets, shoes (specialised stores 'Belarusian shoes' are spread in Russian cities) and garments are also important. Frozen meat (beef, etc.), sugar and milk products are the main food products exported to Russia. It is worth mentioning that Belarus has a positive trade balance with Russia in food and agricultural products and most of finished goods, though the balance in raw materials, fuel and intermediate goods remains negative.

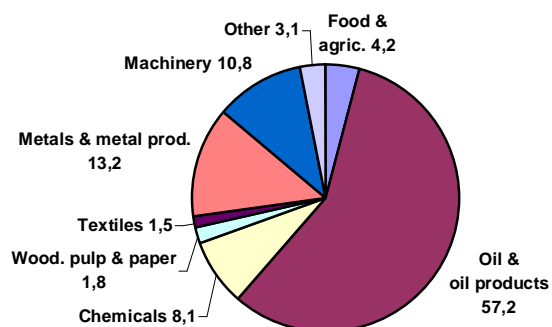
**Chart 2. The Belarusian exports to Russia by commodity, Jan.-Nov. 2006, %**



Calculations based on data from Belarus customs: [www.gtk.gov.by](http://www.gtk.gov.by).

The oil and oil products dominate in the Russian exports to Belarus. In 2006, they amounted to 57% of the total value of the exports. The share of fuel will increase even more since Russia imposed an export duty on oil exports to Belarus in the end of 2006. Metals (mostly ferrous), machinery and chemicals constitute other important groups of items of the Belarusian imports from Russia - 13%, 11% and 8% respectively (see Chart 3).

**Chart 3. The Belarusian imports from Russia by commodity, Jan.-Nov. 2006, %**



Calculations based on data from Belarus customs: [www.gtk.gov.by](http://www.gtk.gov.by).



Here, one should take into account the fact that the quality of the trade statistics is inadequate for several reasons. The precise accounting of the mutual trade between two countries is impossible due to an absence of the customs statistics and border control. Customs are the main source of foreign trade statistics in Russia, but the data for trade with Belarus is taken from different sources, i.e. the information is gathered from the Statistics Agency data based on accounting reports. During the past couple of years, the Russian authorities reinstalled de facto 16 customs posts on the border with Belarus to control goods imported from the third countries. However the customs posts do not register goods, originating from Belarus, because of a free trade regime. There are no customs on the Belarusian side of the border, and hence the data from the Belarusian customs web-site also originates from accounts provided to the Statistics Agency.

The second source of inadequacy is the existence of the informal economic ties. For instance, the shuttle trade has been an important component of the mutual trade and an important way of survival for the citizens of these two countries during the toughest period of the transformation in the beginning of the 1990s. The main items brought by the Belarusians for sale at the Russian marketplaces were at that time smoked sausage, butter and canned and sweetened condensed milk. The price difference between the two countries was explained not only by natural conditions and the agricultural specialisation of Belarus, but also by the continued subsidising of milk products and some other basic food items in Belarus.

It is interesting to mention an odd situation which took place in the butter market. The inhabitants of the eastern border regions of Belarus used to buy subsidised butter in Belarus, and thereafter re-sold it in the adjacent Russian provinces. An excessive demand for butter lead to its deficit in Belarus as a whole and the Belarus Government sometimes had to buy additional amounts of product in Russia – certainly paying the higher Russian prices. By the end of the 1990s food prices converged, and the role of shuttle trade diminished.

## 5. Oil and natural gas trade and its role in the mutual relations

Belarus does not possess significant energy resources, and hence, the country is dependent on the imports of oil, natural gas, and, to some extent, electricity. Fuel plays an important role in the overall imports of Belarus. The mineral products constitute 1/3 of the total USD 17 billion imports<sup>4</sup> (see Table 3).

**Table 3. Energy dependence of Belarus, 2004**

	<b>Oil, bbl/day</b>	<b>Natural gas, billion cu m</b>	<b>Electricity, billion kW</b>
Production	36,000	0.25	40.5
Exports	14,500	0.00	0.8
Imports	360,000	20.50	7.0
Consumption	252,000	20.50	34.3

Source: World Factbook, 2006 ([www.cia.gov](http://www.cia.gov)).

During the winter 2006-07, Russia triggered two conflicts with its ally, urging reform in energy trade. The first conflict was in the sphere of natural gas pricing, the second concerned oil. In order to comprehend the situation, it is necessary to study the background of the natural gas crisis.

In April 2002, Russia and Belarus signed an agreement on the principles of the natural gas supply. Gazprom took an obligation to supply gas at Russian domestic wholesale prices (at that moment USD 30 per 100 cubic metres), and Belarus was ready to organise a joint-venture based on Beltransgaz, the main firm responsible for the transit of the Russian natural gas via Belarus westwards, no later than July 2003. However this agreement was never fulfilled due to different approaches to the price of Beltransgaz. Gazprom offered to buy a half of Beltransgaz, but the price offered for this shares was too low – USD 200-300 million. Lukashenka named his price - USD 5 billion.

In the beginning of 2004, talks reached a deadlock and Gazprom considered itself free of previous obligations concerning the supply of gas to Belarus with the domestic prices. It offered gas at USD 50 price (commercial price at that moment), which Minsk rejected. Gazprom stopped delivery.

---

<sup>4</sup> [www.intracen.org/countries](http://www.intracen.org/countries).

For several months, gas was supplied under short-term agreements by independent small companies. In February 2004, a several hours break in gas supply to Europe happened. Finally, Minsk surrendered and signed an agreement with USD 47 price.

The world prices continued to increase during the following years, and in the end of 2005 supported by the Russian President Gazprom started to increase natural gas prices for the CIS countries. Armenia, Azerbaijan, and Georgia had to pay USD 110 per 1000 cubic metres, and Ukraine, after a severe conflict, agreed with the price of USD 95 for a gas blend, containing 80% of the Turkmen gas (priced at USD 60) and 20% of the Russian gas, allegedly sold at USD 230 per 1000 cubic metres (see Table 4).

**Table 4. Prices for natural gas supplied by Gazprom, USD per 1000 cubic metres**

	<b>2005</b>	<b>2006</b>	<b>2007</b>
The Baltic States	80	115-155	210-260
Ukraine	40	95	130
Belarus	47	47	100
Georgia	110	110	230
Armenia	110	110	110
Azerbaijan	110	110	-
Western Europe	220-250	220-250	220-250

Source: Gazprom and different news agencies.

Nevertheless, Belarus remained in a privileged position, paying USD 47, as before. According to an agreement of the end of 2005, the transit fee for the Russian natural gas moved to Europe via Belarus by the Beltransgaz pipeline was set at USD 0.75 per 100 km transfer of 1000 cubic metres and by the Yamal-Europe pipeline was set at USD 0.46. It was decided to keep the gas prices for Belarus constant for one more year more (USD 46.7 per 1000 cubic metres) thanks to a successful settlement of Gazprom's property rights for the Belarusian part of the Yamal-Europe pipeline. The land under this pipeline was leased to Gazprom on the long-term basis.

However, this agreement did not cover the years to follow, and in November 2006, the Russia's Ambassador to Minsk Alexander Surikov, announced USD 200 as the price for 2007 and after. The Belarusian Government expressed discontent and menaced to use the retaliation, including a possible increase in rental payments for the Russian military installations in Vileika and Baranovichi and an increase in transit payments for fuel and trucks. Moreover, a revision of Transneft's property rights of Zapadtransnefteprodukt, Belarus' main export pipeline for petroleum products, was mentioned<sup>5</sup>.

Difficult talks started and the final agreement was signed at the very end of December 2006, just two minutes before the New Year. The main items of the New Year agreement are the following:

- 1) The gas price for 2007 is set at USD 100 per 1000 cubic metres. After the year 2007, the price for Belarus will be calculated on a European price basis, but with lowering coefficients: 67% for 2008, 80% for 2009, 90% for 2010 and 100% for 2011. The domestic price for industrial consumers in Russia in 2011 will also be calculated at 100% of the European level, so the two countries (at least their industries) will face similar conditions.
- 2) The Beltransgaz' 50%-share will be bought by Gazprom for the price determined by an independent evaluator (ABN-Amro), i.e. for USD 2.5 billion, which will be paid in 4 years in 4 equal instalments.
- 3) The fee for the transit of the Russian gas through Belarus will be raised from USD 0.75 to USD 1.45 per 100 km for 1000 cubic meters of gas, and this fee will be stable for five years<sup>6</sup>.

Just after the first conflict had been solved, another one started in January 2007, with oil export duties now becoming the source of discord. Russia expressed its dissatisfaction with the fact that Belarus was buying Russian oil with low Russian prices, and thereafter, re-exported oil as well as refined oil products at the world prices, imposing an export duty, which became an important source of the budget revenues for Belarus. According to Belarus' interpretation, it met the conditions of the Union Treaty as well as the rules of the customs union.

---

<sup>5</sup> <http://www.rian.ru/review/20061229/58096207.html>.

<sup>6</sup> Press-conference of Alexey Miller (head of Gazprom) and Sergey Sidorsky (prime-minister of Belarus) of January, 1<sup>st</sup>, 2007 – from the web-site of Belarus embassy to Russia.

Russia's increasing oil prices could bring solution to this problem. But it looked inappropriate because of a consequent loss of the price competitiveness of many Russian commodities. Instead, the Russian Government demanded that 85% of the Belarus export duty on oil should be transferred to the Russian budget. Lukashenka neglected this request. Russia responded by imposing of an export duty of USD 180.7 per tonne on oil exports to Belarus. Belarus' reply was imposing of a transit duty for the Russian oil.

Russia's refusal to pay led to a temporary suspension of oil pumping to Europe through the Belarusian pipelines. The oil conflict was close to expanding to other spheres of the bilateral relations: sugar trade, car travels – for instance, the Belarusian car-owners travelling to Russia were requested to pass a special registration of temporary imports of their cars. Finally, the conflict was resolved after a phone-talk between the two presidents and difficult talks of the prime-ministers.

According to the final agreement of January 2007, Belarus increases its own export duty from USD 128.2 up to USD 180.7 per tonne, i.e. to Russia's export duty level, while Russia decreases its export duty for oil to Belarus. Russia will collect only part of its regular export duty, which is subject to changes in line with changes in the world prices; in 2007 – 0.293, in 2008 – 0.335, in 2009 – 0.356 of the export duty which will be in effect at that moment. In practice, this means that the Russian-side duty for 2007 equals to USD 53.0 per tonne.

It is presumed, though not written in the document, that the sum collected on the Russia-Belarus border will be deducted from the duty levied on the Belarusian western or southern border. Russia will receive the growing part of the Belarusian export duty: 70% in 2007, 80% in 2008 and 85% starting from 2009. Besides these concessions, Belarus will also call off up to 40 laws and 200 presidential decrees limiting the activity of the Russian firms in Belarus<sup>7</sup>.

---

<sup>7</sup> www.lenta.ru, 15.01.2007; <http://www.afn.by/news>.

## **6. Mutual investments**

Russia is the second largest source of foreign investments to Belarus after Switzerland. Until the beginning of 2004, Russia had been number one in terms of established joint ventures and foreign companies in Belarus (579 or 20% of the total number of foreign-owned enterprises). However the scale of these investments is not very impressive: USD 307 million in 2004, which is 20% of the total foreign investment inflow during that year. In 2005, the amount of these investments was three times less – USD 102 million only<sup>8</sup>. It is evident though that Gazprom's acquisition of a half of Beltransgaz will change the statistics substantially.

The Belarusian investments are present in the Russian economy as well. As of 2003, 465 enterprises partly or fully belonging to the Belarusians existed in the Russian Federation, i.e. about 3% of the total number of companies with foreign capital in Russia. More than a half of them were located in Moscow and the Moscow region<sup>9</sup>. Visitors to the Belarusian Embassy to Russia web-site can find there Moscow-located addresses of 50 representative offices of the Belarusian firms. The majority of the Belarus companies in Russia are industrial ones. Many of them are promoting sales of the Belarusian manufactured goods – special transport and construction machinery (BelAZ, MTZ), electric appliances (Belvar, Vityaz), furniture (Gomeldrev), footwear, wall tapestry, etc. Some are engaged in the maintenance of heavy machines, e.g. tractors and dump-trucks from MAZ (Minsk Automobile Plant).

The main difference between the Belarusian investments in Russia and the Russian investments in Belarus results from the fact that the Russian investments are mostly conducted by private companies (with an exception of Gazprom and Russia's defence-oriented projects), while the Belarusian investments originate from the public sector.

A number of joint ventures exist in the defence industry, and new ones are planned to be established. Several Belarusian and Russian plants and research bureaus are united under so-called MFPGs (International financial-industrial groups): Tochnost (Preciseness),

---

<sup>8</sup> <http://guide.export.by/rus>.

<sup>9</sup> Регионы России. Социально-экономическое положение. М., 2004.

Oboronitelnyie Systemy (Defence Systems), and Electronnyie Technologyii (Electronic Technologies). Others comprise smaller joint ventures, such as Vizir and Soelis<sup>10</sup>.

Private Russian investors to Belarus include Evroset, a retail trader of mobile phones, with 85 stores in Belarus and plans to double the number during 2007. Food retail chains are invading the Belarusian market, among them Sedmoy Continent, which plans to create a new chain, and Viktoria, which bought Rublevsky chain of mini-markets in Minsk<sup>11</sup>. Furthermore, Rosintekh plans to build a plant for the utilisation of outdated pesticides in Chechersk (Gomel Province). Some 30% of cheese plant in Vysokovsk belongs to Russian partners, and cheese is partly exported to Russia<sup>12</sup>. The aforementioned companies are just examples of the investments between Russia and Belarus.

## **7. Trade in services**

The trade in services with Russia is not reflected in the official statistics, although it undoubtedly exists. Transit transportation has to be mentioned being particularly important, and it is not only the transit of oil and natural gas westwards. Also other goods are transported from Russia to Europe and from Europe to Russia via Belarus. Not long time ago, Belarus imposed an obligatory convoy of trucks across the country with the obligatory payment for this safety-providing service. This payment caused a partial diversion of traffic to the trans-Baltic routes. Another slowing factor of the transit via Belarus is the road police bribery. The road police in Belarus may be even more corrupt than its counterpart in Russia.

Belarus is a natural channel for the informal trade to Russia. The transit of used cars from Germany to Russia and other CIS countries forms a major part of the informal trade.

Passenger traffic is quite intensive as well. Hundreds of buses from different Russian cities, including the remote ones, such as Novosibirsk, cross Belarus every week on their way to Germany and back.

---

<sup>10</sup> [www.vpk.gov.by/news](http://www.vpk.gov.by/news).

<sup>11</sup> <http://finance.rol.ru/news>.

<sup>12</sup> Belarusian embassy to Russia data.

Furthermore, Belarus provides its territory for the military facilities used by the Russian army, but the discussion on payment for their use wakes up only during the tough moments of the mutual relations.

## **8. Regional aspects of economic relations**

The cross-border trade and other links are especially important and often very fruitful for border regions. Economic agents can use institutional differences while minimising transportation expenditures. For the Russian provinces located east of Belarus, it is an absolutely unchallenged direction of trade, as it provides additional incomes. For instance, the share of Belarus in the foreign trade of the Bryansk region is 40% and 96% in the Smolensk region. It is interesting to note that per capita income in Smolensk is 1.4 times larger than in the Bryansk region<sup>13</sup>. Other provinces of Russia are also intensively engaged in trade with Belarus.

More than 8000 firms of these two countries are engaged in co-operation, supplying each other with raw materials, intermediary goods and spare parts. The number of inter-province agreements on co-operation exceeds 200. Besides, the establishment of several Belarusian business-centres is planned in the main Russian cities in the near future.

## **9. Migration and education exchange: Problems of migrants**

The Treaty on Equal Rights of Citizens between Belarus and Russia was signed in 1998, covering employment, an access to medical care and education. But situation is not absolutely smooth due to peculiarities of laws in Belarus and Russia. A lot of the Belarusians come to the Russian cities and work in construction sites. Quite often the Belarusians arrange brigades engaged in finishing work.

---

<sup>13</sup> Вашанов В.А. Совершенствование производственно-хозяйственных связей регионов России и СНГ // Официальный сервер управления международных и внешнеэкономических связей администрации Оренбургской области. <http://www.oblves.orb.ru/>. – cited by Russian Experts' digest. (North-West foundation of strategic research).



The number of temporary migrants is difficult to assess, for most of them are working in the informal sector. The Belarusians are competitive in the Russian market, since they have a reputation of more qualified and more reliable workforce than citizens of some other post-Soviet republics. Migrants, applying for high-qualification jobs, enjoy the advantages of the mutual recognition of the university diplomas.

In addition, the citizens of these two countries have a right to apply to the colleges and universities of both countries, not only on the commercial basis but also on the budget basis, i.e. the education is paid by the government. However, not many students use this opportunity. The total number of the Belarusian students in the Russian universities, and correspondingly, the Russian students in the Belarusian universities adds up to 5000, this number being rather evenly distributed among Belarus and Russia.

The reason for the low intensity of the student exchange lies partly in a higher cost of living in Russia (especially in Moscow and St. Petersburg) for the Belarusian students, since household incomes are generally lower in Belarus. Correspondingly, the Russian students may be hampered with the rule, which makes it obligatory for the graduates of the Belarusian universities to work for three years in a place, determined upon their graduation. Though it is not clear, though, how this rule can be exercised if the Russian graduate just leaves Belarus and seeks for a workplace outside Belarus. Probably, the most appropriate explanation for the poor student exchange is a lack of information about this possibility and a lack of incentives for such an exchange. It is worth mentioning that the number of the Chinese students in Belarus is higher than the number of the Russian ones.

There are some other problems putting limits on the educational migration. For instance, the Russian universities do not recognise results of the Belarusian school graduation tests and so-called gold medals, which give the Russian school graduates privileges in the competition for places in universities and colleges.

The right to get free medical care is real only in case of emergency. The standard Russian medical insurance policy, which is obligatory for acceptance in Russia, is not acceptable in

Belarus. Correspondingly, the Belarusians legally working in Russia are given medical insurance by their employers, but those employed informally and the students have to pay their medical insurance themselves, which is costly. As of 2006, a new agreement, providing an equal access of the citizens of the Union State to medical services (not only emergency), was under the ratification process.

Retired people, willing to change living place from Russia to Belarus have to wait for their pension rearrangement for 6 months. After this, pensions for the period are reimbursed. The similar procedure in Russia might take even longer, while the reimbursement will be made only for 6 months. In 2005, about 1500 Russian pensioners moved to Belarus, while only 94 people moved in the opposite direction. Similar pension level and cheaper life in Belarus might partly explain this difference.

#### **10. Foreseeable impact of Russia's accession to the WTO on the Russia-Belarus relations**

Both Russia and Belarus applied for the WTO membership in the 1990s, and they held separate negotiations despite the formation of a common customs union. It looks as if the WTO accession had a priority over the bilateral relations in the eyes of the Russian authorities, or probably, they were not able to see a contradiction between the two goals. A semi-communist model of the Belarus economy remains the main obstacle on the way of Belarus' quick WTO accession, as well as bad personal relations of Lukashenka with political leaders of the West.

Russia is much closer to reaching the WTO. It made a number of concessions to its WTO partners, some of which have already been implemented. Some of them will be implemented upon the accession or after a transition period. It means that Russia's external tariff, non-trade barriers and legislation are changing. In such a situation, Belarus has two options: one is to adjust its own legislation to the Russian one or reconcile itself to rift from the economic fundamentals of the mutual relations. Assumingly, the Russian leaders are certain that Belarus will have no choice but to follow Russia.

After Russia has joined the WTO, the Customs union agreement with Belarus has to pass registration in the special WTO body for testing its relevance with the Article 24 of the GATT rules and the GATS-5 rules. If the result is negative, Russia might be asked to abolish the privileges and preferences granted to Belarus, or to adjust the conditions of that treaty.

## **11. Conclusions**

Belarus and Russia are strongly connected in various fields, and the peoples of these two countries are very close to each other. We can say that in some sense relations of these two nations resemble those of Canada and the USA. These countries with a different scale of economy but have similar lifestyles and they are neighbours, partners and allies.

Despite growing trade with the EU, Belarus is still extremely dependent on its trade relations with Russia, which is supplying necessary fuel and remains the main market for the Belarusian heavy industry, light industry and agriculture. The transit transportation is the key sphere of the bilateral trade in services, and both countries are equally dependent on each other in this field. The public sector plays an important role in the mutual economic relations, especially from the Belarusian side. The energy sector and the defence industry are among the main spheres of the mutual co-operation. Inter province agreements are good instruments for promotion of manufactured goods to local markets in Belarus and Russia. Mutual investments are substantial, especially those from Russia to Belarus. The Russian retail chains are aggressively expanding in Belarus, while Transneft and Gazprom are acquiring large stakes in the Belarusian pipeline systems. A slow pace of privatisation in Belarus is the main obstacle for a greater Russian business expansion in this country.

The Treaty on the Creation of a Union State of 1999 and consequent agreements provide a legal framework for far-reaching integration of two countries. In particular, it grants a kind of the Union citizenship for the Belarusians and the Russians – they have equal employment rights and an access for public services in both the countries. The Belarusian workers are extensively using this opportunity, migrating to large Russian cities.

The goal of transferring to the common currency has not been realised due to political obstacles.

The political leaders play a particularly crucial role in the mutual relations of these two countries. The history of Belarus-Russia relations after the break-up of the USSR can be divided into several periods depending on the leaders' mutual relations.

*The period 1992-1994:* a parallel chaos of inconsequent liberal reforms, the partial collapse of cross-border technological chains and the growth of the shuttle trade.

*The period 1994-2000 (the Lukashenka-Yeltsin period):* the divergence of the economic systems due to the inhibition of the market transformation in Belarus, a series of formal bilateral agreements, i.e. a kind of a barter exchange of friendship and devotion from Lukashenka's side for economic privileges for Belarus from Yeltsin's side.

*The period 2000-2007 (the Lukashenka-Putin period):* during his first term, Putin still hoped to implement integration projects, the common currency being perhaps the most essential of them, and to strengthen economic and political ties between the two countries further. Well-known changes in the government-big business relations in Russia, the colour revolutions in some CIS countries and the preparatory work for the WTO accession were factors, which stimulated a turn to a more pragmatic policy towards neighbouring post-Soviet countries, and Belarus has not become an exception. The divergence of social, economic and political systems of Russia and Belarus is now less evident than during the last decade. In many aspects Russia is moving towards the Belarus model, i.e. the political system in Russia is becoming more authoritarian, some large private companies are de-facto renationalised or put under control of federal authorities, social imbalances and problems of the Yeltsin period are to some extent fixed.

Paradoxically, this process has not led to the improvement in relations between the leaders of these countries. Putin and his team are not sentimental and seek a definite outcome from an ambiguous situation. Their clear (though not literally pronounced) goal is that Belarus would join the Russian Federation. Otherwise, they consider it irrational to continue subsidising Belarus. Putin openly announced his estimate on the price of the Belarus subsidising for Russia: *"3 billion of USD annually for promises of unification"*. German Gref, Russia's Minister of Economic Development and Trade, expressed the similar statement in his own way: *"we are ready to pay for the unification, but not for the promises of the unification"*.

The shock therapy in the bilateral relations during the winter 2006-2007, which raised natural gas prices and withdrew profits from the Belarusian oil exports, is a blow to the Belarusian finances and to Lukashenka's system of power. In short run, it undoubtedly worsens mutual relations, but brings them on a more rationale basis in medium term.

## References

- [www.stat.gov.by](http://www.stat.gov.by).
- [www.gtk.gov.by](http://www.gtk.gov.by).
- [www.cia.gov/worldfactbook](http://www.cia.gov/worldfactbook).
- [www.iiseps.org](http://www.iiseps.org).
- [www.regnum.ru/news/632235.html](http://www.regnum.ru/news/632235.html). 28.04.2006.
- Rossiyskaya gazeta, 27 dec. 2006.
- [www.intracen.org/countries](http://www.intracen.org/countries).
- [www.rian.ru/review/20061229/58096207.html](http://www.rian.ru/review/20061229/58096207.html).
- Press-conference of Alexey Miller (head of Gazprom) and Sergey Sidorsky (prime-minister of Belarus) of January, 1<sup>st</sup>, 2007 – from the web-site of Belarus embassy to Russia.
- [www.lenta.ru](http://www.lenta.ru), 15.01.2007; <http://www.afn.by/news>.
- <http://guide.export.by/rus>.
- Регионы России. Социально-экономическое положение. М., 2004.
- [www.vpk.gov.by/news](http://www.vpk.gov.by/news).
- Belarusian embassy to Russia data.
- [www.oblves.orb.ru](http://www.oblves.orb.ru) – cited by Russian Experts' digest. (North-West foundation of strategic research).
- [www.stat.gov.by](http://www.stat.gov.by)

# **Russian investments in Belarus**

Peeter Vahtra

## **Contents**

1.	Introduction	133
2.	An overview on Russian OFDI	134
2.1.	Russian OFDI in a global context	134
2.2.	Russian FDI in Belarus	139
3.	The largest Russian companies in Belarus	141
3.1.	Natural gas	142
3.2.	Oil and oil products	143
3.3.	Mobile telecommunication	145
3.4.	Other sectors	146
4.	Conclusions and future implications	147
	References	150

## 1. Introduction

Russia is the largest outward investing country among the Commonwealth of Independent States (CIS), and the 15<sup>th</sup> largest investor in worldwide comparison. Russian companies have been particularly active in investing in the neighbouring CIS countries. The expansion of Russian enterprises to the developed markets is a more recent phenomenon. With a focus on strategic sectors of the target economies, Russia is the largest foreign investor in most of the CIS countries. The leading Russian energy companies, such as Gazprom and Lukoil, have equity investments in virtually all the CIS countries. In addition, the leading Russian companies dominate the energy sectors of several of its neighbouring countries.

Until recent, Russia and Belarus have been the closest allies among the former USSR republics. Given the huge trade imbalance between the two countries<sup>1</sup>, the relations between Russia and Belarus have traditionally been far from market-based but, to a large extent, built on intergovernmental agreements and close political relations. Belarus' authoritarian President Aleksander Lukashenko had vowed his political support to Moscow in exchange to receiving Russian energy supplies at preferential prices. Until 2007, Belarus received Russian crude oil and natural gas practically at the domestic prices of Russia, leading to huge annual subsidises to the Belarusian economy<sup>2</sup>.

Until the end of 2006, the development of relations between the two countries envisaged further economic and political integration. However, the relations between the countries begun to deteriorate in 2006 after a dispute over energy prices, similar to that witnessed between Ukraine and Russia a year earlier.

Along with the recent deterioration of the relations between the two countries, the issue of Russian investments in Belarus and related control over the country's industrial assets has

---

<sup>1</sup> In 2005, Russia accounted for 36% of Belarusian exports and 61% of Belarusian imports (Ministry of Statistics and Analysis of the Republic of Belarus, 2007). In contrast, the respective shares for Belarus in Russia's foreign trade were 6% for exports and 4% of imports (Goskomstat 2007).

<sup>2</sup> As stated by Russia's President Vladimir Putin, the Russian energy subsidies for Belarus will reach USD 5.8 billion in 2007. In contrast, amid the recent energy dispute, his Belarusian counterpart Aleksander Lukashenko has dismissed the claims on subsidises as "*ridiculous*" (RIA Novosti 2007a/b).

significantly gained on importance. As the advantageous geopolitical location of Belarus<sup>3</sup> is its strongest trump card in negotiations against Russia, the control over major Belarusian infrastructure assets appeared as a key issue in the recent dispute over the energy supplies from Russia.

Against this background, this article discusses the Russian foreign direct investments (FDI) and acquisitions in Belarusian economy, with insights into overall FDI trends in Belarus. By presenting the cases of largest Russian FDI in Belarus, the article aims to elaborate on strategic importance of Russian investments in the country and assess the future prospects for Russian companies in Belarus. As the recent deterioration of the relationships between Russia and Belarus is bound to have an impact on economic co-operation and FDI flows between the countries, the origins and outcomes of the energy dispute will be discussed in connection to Russian business presence in Belarus.

The article is structured as follows. Chapter 2 provides a brief overview on Russian outward foreign direct investments (OFDI) with a focus on the CIS (Chapter 2.1). In Chapter 2.2, a statistical overview on Russian investments in Belarus is provided in a context of overall inward FDI in the country. Chapter 3 discusses the activities and investments of the largest Russian companies in Belarus. Chapter 4 presents conclusions and future outlook for Russian FDI in Belarus.

## **2. An overview on Russian OFDI**

### **2.1. Russian OFDI in a global context**

Russian OFDI have grown rapidly during this millennium, from mere USD 20 billion in 2000 to nearly USD 140 billion in 2005 (Figure 1). While the rapid rise in Russian OFDI can largely be attributed to increasing international activities of the Russian transnational corporations (TNCs), the recent improvements in OFDI data registering by the Central Bank of Russia are partly responsible for the dramatic increase in the investment statistics.

---

<sup>3</sup> Some 20% of Russian natural gas and up to two thirds of the crude oil deliveries to Europe run through Belarusian territory.



**Figure 1. Development of the Russian OFDI stock (USD billion)**



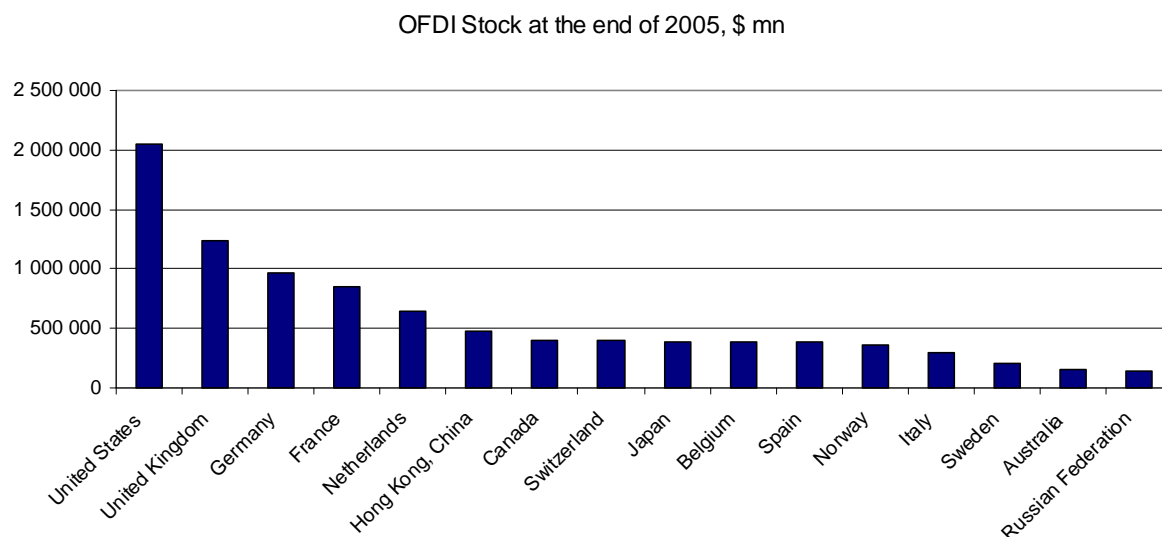
Sources: UNCTAD (2006a), Central Bank of Russia (2006).

At the end of 2005, Russia ranked as the 15<sup>th</sup> largest foreign investor country in the world (Figure 2). With its OFDI stock nearing USD 140 billion, Russia is the second-largest investor among the emerging economies after the South-East Asian financial hub, Hong-Kong, China. Besides the official FDI, massive amounts of capital have left Russia as unregistered capital flight. Although widespread controversy exists concerning the total amount Russian investments and capital abroad<sup>4</sup>, it is widely acknowledged that the actual figures are considerably higher than suggested by the official data on OFDI.

---

<sup>4</sup> Various estimates are provided on additional capital flight from Russia. According to the European Commission, the non-recorded capital flight from Russia totalled USD 245 billion in 1992-2002. In addition, the composition of capital outflows from Russia highlights widespread misreporting and undervaluation of revenues from abroad. To put it differently, Russian companies systematically undervalue their export earnings and report remittances against fictitious imports and transactions in securities. Only in 2005, this item on the balance of payments of the Russian Federation accounted for USD 27 billion, according to the Central Bank of Russia.

**Figure 2. World's largest foreign investing countries in 2005, USD million**



Sources: UNCTAD (2006a), Central Bank of Russia (2006).

During the past years, the leading Russian TNCs have pursued an aggressive strategy in acquiring foreign assets. Besides the increased number of foreign acquisitions, the value of asset purchases by Russian companies abroad has soared. Table 1 presents the largest foreign acquisitions by Russian companies during 2004-2006.

Majority of the Russian companies' foreign mergers and acquisitions have taken place during this millennium, indicating the growing international activeness of the Russian firms. The leading Russian energy and metal companies have already become truly global majors with the telecommunication companies following the suit by expanding actively in the CIS region. Backed by the soaring energy revenues, the Russian oil and gas majors have been in recent years active in searching for foreign acquisition targets. More importantly, the geographical scope of their activities have expanded from the traditional CIS region to cover the whole world as proved by acquisitions by the leading Russian oil company, Lukoil, in North America, the world's largest natural gas producer, Gazprom, in the European Union, and the metal giants Norilsk Nickel and RusAl in Africa, among others. In large, Russian outward FDI remains heavily concentrated in the natural resource-based sectors. Further, few leading companies account for significant majority of

outward investments from Russia.

**Table 1. The largest foreign acquisitions by Russian companies in 2004-2006  
(planned and realised)**

Acquiring company	Target company	Country	Nature of business	Share, %	Value, USD million
Altimo	Turkcell	Turkey	Mobile telecommunication	13	3 200
Gazprom <sup>5</sup>	Beltransgaz	Belarus	Natural gas distribution	50	2 500
Evrast Holding	Oregon Steel Mills	USA	Steel production	100	2 300
Lukoil	Nelson Resources	Kazakhstan/Canada	Oil exploration & production	100	2 000
Norilsk Nickel	Gold Fields Ltd	South Africa	Gold mining	20	1 200
Evrast Holding	Highveld Steel	South Africa	Steel products	79	678
Evrast Holding	Palini & Bartoli	Italy	Steel products	75	650
Severstal	Lucchini Group	Italy	Steel products	62	574
RusAl	Queensland Alumina Ltd	Australia	Alumina refinery	20	460
VimpelCom	Kar-Tel	Kazakhstan	Mobile telecommunication	100	425
Evrast Holding	Vitkovice Steel	Czech Republic	Steel products	100	287
VimpelCom	Buztel and Unitel	Uzbekistan	Mobile telecommunication	100	275
Lukoil	Teboil and Suomen Petrooli	Finland	Petroleum marketing	100	270
Lukoil	-	USA	795 petroleum stations from ConocoPhillips	100	266
VimpelCom	Ukrainian Radio Systems	Ukraine	Mobile telecommunication	100	254
RusAl	Alscon	Nigeria	Aluminium production	78	250
MTS	Uzdunorbita	Uzbekistan	Mobile telecommunication	74	121
Evrast Holding	Strategic Minerals Corporation	USA	Steel production	73	110

Sources: Company information; author's calculations.

Regarding the geographical distribution of Russian OFDI, the recent development has largely been twofold. On one hand, the scope of Russian investments has expanded dramatically in recent years covering practically the whole globe. Increasingly, Russian companies engage in asset purchases in the established markets of the EU and the USA, among others. On the other hand, as suggested by the UNCTAD (2006b) data on cross-

<sup>5</sup> By 2010, Gazprom will gradually acquire 50% of the company. The first transfer of 12.5% of the Beltransgaz shares is due in June 2007.

border mergers and acquisitions (M&A) by Russian companies, the share of CIS among the Russian OFDI has again grown in recent years. Measured by the number of deals, over a half of the Russian M&A purchases have taken place in the CIS region, whereas the developed countries account for around 40%.

In addition, the value of foreign acquisitions in the CIS region has grown dramatically in recent years. The days of cheap asset stripping belong to the past and one may already have witnessed several multibillion acquisitions in the region. Moreover, the assets controlled by Russian companies in the CIS countries tend to be highly strategic in nature, such as the energy or infrastructure assets. The Russian companies also hold prominent positions on the CIS markets, whereas in developed economies they have considerably smaller leverage in key industries of the target countries.

A closer look to Russian investments in the CIS reveals several problems in producing reliable estimations on Russian FDI in the region as the official statistics on Russian investments in the CIS tend to be highly misleading. Table 2 presents an overview of the Russian FDI flows to the CIS, as reported by Goskomstat.

**Table 2. Russian annual FDI flows to the CIS, 2003-2005**

	2003		2004		2005	
	USD 1000	%	USD 1000	%	USD 1000	%
Total	544 141	100	713 016	100	620 522	100
Azerbaijan	1 613	0.0	2 379	0.3	6 734	1.1
Armenia	7 650	1.8	1 033	0.2	138 185	22.2
Belarus	243 355	41.0	280 193	39.3	102 438	16.5
Georgia	1 182	-	284	0.0	60	0.0
Kazakhstan	27 135	2.6	84 104	11.8	204 314	32.9
Kyrgyzstan	608	0.6	628	0.1	1 247	0.2
Moldova	372	0.1	6 600	0.9	4 904	0.8
Tajikistan	18	0.0	3 067	0.4	496	0.1
Turkmenistan	857	0.4	1 865	0.3	-	-
Uzbekistan	582	0.8	138 547	19.4	6 968	1.1
Ukraine	260 769	52.7	194 316	27.3	155 176	25.0

Source: Goskomstat 2007.

As shown in Table 2, the Russian investment flows to the CIS, totalling USD 620 million in 2005, are relatively negligible on the face of total OFDI from Russia in 2005, amounting to

over USD 13 billion. Further analysis of somewhat differing Russian and CIS statistics shows that the region accounts for between 1% and 5% of Russia's total OFDI. In this respect, one might regard Russia as a negligible investor in the CIS. However, one only needs to take a brief look on some of the largest individual investment projects by Russian companies in the CIS to see that the FDI statistics alone are insufficient in portraying the actual presence of Russian companies in the region<sup>6</sup>. In this article, the focus is upon the role of Russian companies in Belarus<sup>7</sup> and their distinct leverage on the country's economy.

## **2.2. Russian FDI in Belarus**

According to Goskomstat (2007), Belarus has been the leading CIS country in attracting Russian investments<sup>8</sup>. Similarly, according to the National Bank of Belarus (2007), Russia has been the leading foreign investor in Belarus throughout the 2000s. In the peak year of 2005, Russia accounted for over 80% of Belarusian FDI inflows (Figure 3). One must note, however, that although the level of Russian investments in the country may seem high at first glance, this is mainly due to the fact that the overall level of inward FDI in Belarus remains extremely low.

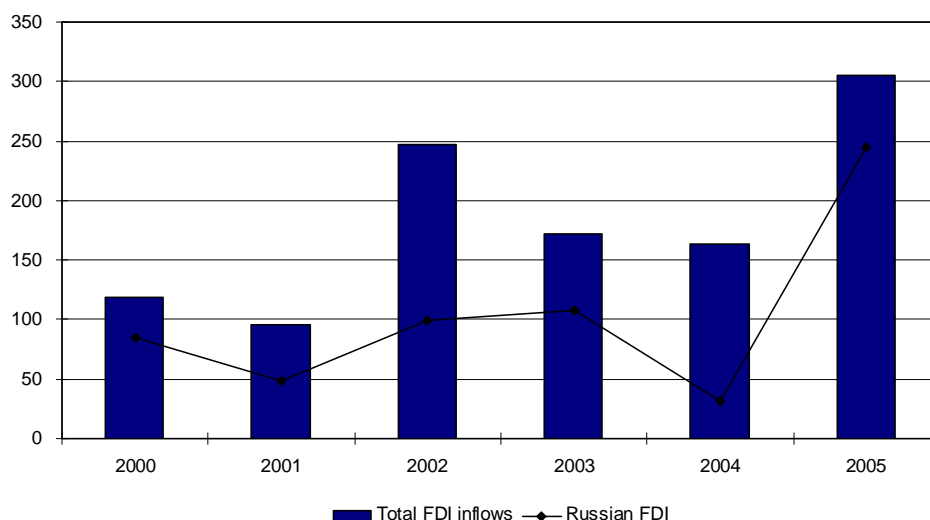
---

<sup>6</sup> The statistical discrepancies occur for mainly three reasons. First, major Russian companies invest abroad through offshore investment units or third countries (investment trans-shipping) and the investments are not registered as of Russian origin in the recipient countries. The registration practices understandably vary from one country to another, but the essential problem of identifying the ultimate beneficiary behind the investment is shared by all the countries in the region. Second, in many instances, the investments by Russian companies are not regarded as FDI by definition. In particular, this goes for the massive investments in the exploration and infrastructure projects, operated by existing subsidiaries or joint ventures in the host countries. After a company or joint venture is established, the further investments or ownership changes in this company are not regarded as FDI, but often categorised as 'other investments' in the balance of payments of the host economy. It is claimed here, however, that this statistical treatment, however, does not lessen the investor company's leverage in the target market. Third, the inconsistencies may partially root to the operations of Soviet enterprises abroad, where most of these assets are inherited by contemporary Russian enterprises. Complications in valuation of these assets clearly add to the problem of statistical inaccuracy and inconsistencies.

<sup>7</sup> For case studies on other CIS, see Vahtra (2005, 2006).

<sup>8</sup> It will be argued later, that the actual level of Russian investments is considerably higher in countries such as Ukraine and Kazakhstan, despite their lower statistical performance of attracting Russian FDI.

**Figure 3. FDI inflows in Belarus, USD million**



Source: National Bank of Belarus 2007.

According to the Belarusian sources, the Russian FDI in the country amounted to USD 245 million in 2005 and USD 32 million in 2004. Significantly different figures are posted by Goskomstat – according to the Russian statistics, Russian FDI flows in Belarus amounted to USD 102 million in 2005, down from USD 280 million in 2004. As one may easily perceive, there is evidently a considerable divergence in FDI registering practices between the two countries.

Despite the obvious inconsistencies and shortcomings in investment registering practices discussed above, the author claims that Belarus is, to some extent, an exception among the CIS countries regarding the explanation value of FDI statistics and FDI from Russia in particular. There are several reasons to this.

First, the number and value of assets controlled by the Russian companies in Belarus are relatively low compared to those in for instance Ukraine and Kazakhstan. Although the official statistics suggest the Russian investments to be larger in Belarus than Ukraine or Kazakhstan, the latter accommodate significant amount of trans-shipped investments of Russian origin, which can be perceived by looking into individual FDI projects in the countries. In contrast, the value and strategic importance of Russian FDI in Belarus has thus far been significantly lower. This naturally lowers the probability for statistical errors

as there are no realised multibillion FDI deals in Belarus, which could result from trans-shipped investments of Russian origin. We argue that, besides the lack of attractive investment targets in Belarus, one of the main reasons for the lower level of Russian FDI in the country originates from the exceptionally close political and economic relations between the two countries. It has been put forward by a number of scholars, that the motivations behind Russian FDI may often be linked to the country's foreign policy objectives, and even more so in the CIS region (e.g. Heinrich 2003; Liuhto & Jumpponen 2003 a/b; Vahtra & Liuhto 2004; Vahtra 2005). As Belarus had a tradition of being the most loyal ally to Russia among the CIS, there has been less need for Russia to secure its leverage in the country through large-scale FDI in strategic sectors of the economy, as it has done in many other countries in the region.

The second major reason for somewhat higher reliability of FDI statistics is the fact that there has been virtually no political resistance towards Russian investments in Belarus. In many countries in the region, political resistance considerably lowers the reliability of FDI statistics causing the Russian companies to invest through third countries and hide their true identities.

Despite the above reasoning, the official statistics alone remain insufficient in providing information on actual Russian business presence in Belarus. In following, we provide a company-level analysis on the largest Russian investments in Belarus in order to achieve a more comprehensive picture on Russian investments in the country.

### **3. The largest Russian companies in Belarus**

As of 2005, there were roughly 600 registered enterprises in Belarus with Russian equity capital, accounting for some 20% of foreign investment enterprise population of the country (Guide.Export.By 2007). In the current chapter, we concentrate on three sectors that have strategic importance on the Belarusian economy and accommodate the largest Russian investments. In the last subchapter, a brief overview is provided on the Russian investments in other sectors of the Belarusian economy. The key role in the current chapter and in the subsequent discussion is acquired by the energy issues, which, to large extent, dominate the current economic dialogue between the two countries.

### 3.1. Natural gas

**Gazprom**, the world's largest natural gas producer and the leading Russian company by foreign assets, controls an extensive gas distribution network throughout the CIS. Currently, the company primarily targets the Western-European infrastructure and downstream assets, seeking to expand its business empire on its main target markets of the Western EU. With prominent market positions throughout the CIS and most of the CEE, and an increasing grip over the Western European downstream sector, Gazprom is one of the most influential and fastest-expanding business empires in Europe, if not globally.

In Gazprom's European conquest, Belarus occupies a key role as a major transit country of Russian natural gas to the European markets. In Belarus, two major gas pipeline systems are in operation. The majority of Russia's natural gas exports through Belarus are shipped through Yamal-Europe pipeline, the Russian and Belarusian stretches of which are owned by Gazprom. The Belarusian part of the 4000 km-pipeline, connecting the Russian Yamal Peninsula with Germany, was built in 1997-1998 and the construction was fully financed by Gazprom. The Russian gas giant holds the property rights for the pipeline and has a long-term lease agreement on the land beneath the pipeline<sup>9</sup>.

The issue of control over the other gas pipeline, Beltransgaz, became an integral part of Russian-Belarus energy dispute in late 2006. As Gazprom and Russia demanded an end to the preferential price on gas supplies to Belarus and moving to a cash-based supply contracts, the two countries were drawn into a widespread energy dispute similar to that between Russia and Ukraine a year earlier. Referring to the Union State agreement, Belarus strongly opposed the raise in its heavily discounted gas price<sup>10</sup>. Under the threat of supply cut-off starting from 1 January 2007, the deal was stroke at the last moment with what can be considered as significant concessions from the Belarusian side. A five-year contract on Russia's natural gas deliveries to Belarus was signed, at USD 100 per 1000 cubic meters in addition to the right for Gazprom to acquire 50% of Beltransgaz, the

---

<sup>9</sup> Despite the agreements in place, Belarus' President Lukashenko announced a demand for Russia to pay rent for land under gas and oil pipelines in its use running through Belarusian territory (RIA Novosti 2007b).

<sup>10</sup> USD 47 per 1000 cubic meters, compared to the EU average of USD 265 per 1000 cubic meters.



Belarusian gas-transit pipeline and the country's most valuable industrial asset. In many respects, the deal can be considered as a major success for Gazprom, seeking to end the subsidised supplies to the former Soviet republics. In addition, gaining control over one of the key gas infrastructure assets in the region is a major step forward in expanding Gazprom's gas distribution empire in the CIS and the EU.

According to the agreement, Gazprom is to gradually acquire a 50%-stake in Beltransgaz by 2010. The total price for the stake was set at USD 2.5 billion. Despite the seemingly high price tag, one should take into account the additional revenues from the raised gas prices, exceeding USD 1 billion only in 2007. The first transfer of 12.5% of shares in the company to the Russian gas giant for the price of USD 625 million is scheduled to June 2007.

### **3.2. Oil and oil products**

The preferential pricing of crude oil deliveries from Russia and the high refining profit margins have made Belarus a lucrative operative location also for the Russian oil producers. Until the end of 2006, all the major Russian oil companies used to process crude oil in Belarusian refineries. In the beginning of 2007, however, Belarus cancelled all refining contracts of the Russian companies with Mozyr and Naftan refineries. Most likely, the issue of Russian operational and equity participation in Belarusian oil refining industry will be an integral part of the continuing energy negotiations between Russia and Belarus.

Russia is the sole supplier of crude oil to Belarus, having traditionally subsidised the Belarusian economy through a highly preferential pricing. The recent energy dispute between the countries, however, marked an end in the preferential pricing policy. Following the dispute over the gas prices, Russia and Belarus entered into a bitter row over oil export and transit duties. When Russia demanded Belarus to pay oil export duty for Russian supplies to the country in the beginning of 2007, Belarus reacted by introducing a transit fee on Russian oil exported to Europe through Belarus. After heated negotiations and a three-day shutdown of Russian oil supplies to Belarus and Europe, Belarus lifted the transit duty and Russia cut the export duties from USD 180.7 to USD 53.0 per tonne.

Despite the lower export duty settled, the outcome was a major blow for Belarus. Previously, Belarus had received crude oil deliveries to its refineries without Russian export duties<sup>11</sup>, and sold the refined products further to the Western European consumers with considerable profit. Due to significant overcapacity in the major Belarusian oil refineries in relation to domestic demand, large quantities of refined products were sold to the European customers. On estimation, Belarus saved over USD 3 billion in unpaid Russian export duties and collected more than USD 1 billion in governmental export duties in 2005 (ReAKKT 2007). According to the Economist Intelligence Unit, the increase in exports of refined oil products in 2004-2005 accounted for nearly 3 percentage points of GDP growth in these years. In 2005, one third of the country's export revenues originated from the exports of petroleum products.

**Gazprom** has recently gained control over Belarusian oil assets through a series of ownership arrangements in the Russian oil sector. Based on a joint decree by Russian and Belarusian governments, a Russian-Belarusian joint oil company, **Slavneft**, was established in 1992. In 2002, the Belarusian Government sold its share package in the company, with subsequent privatisation of the Russian Government's shares. Through the privatisation process, the Russian-British joint venture TNK-BP and the Russian oil company Sibneft, became the joint owners of Slavneft. In late 2005, Gazprom acquired majority ownership in Sibneft, which controlled a 49%-stake in Slavneft. Subsequently, Sibneft's assets were incorporated in Gazprom's oil producing subsidiary, GazpromNeft.

At present, Slavneft controls 45% in the second-largest oil refinery in Belarus, the Mozyr refinery. The company is a major producer of a wide range of petrochemical products for the Belarusian markets and has been going through considerable modernisation process during the recent years. In addition, Slavneft owns 72 petroleum stations in Belarus.

During the heated negotiations over the energy prices between Russia and Belarus in late 2006, an option was reportedly discussed, to include in the deal a block of shares in the largest Belarusian oil refinery, the state-owned Naftan, in exchange to lower price for natural gas. As it was eventually agreed that Gazprom will get hold on 50% of Beltransgaz

---

<sup>11</sup> USD 180.7 per tonne at the end of 2006.

as a part of the agreement, the Naftan deal was withdrawn from the agenda for a time being. However, both the Russian oil company Lukoil and Gazprom have set their eyes on Naftan for a long time ago, and the Russian ownership in the company is likely to resurface on the agenda between the two countries in the near future.

The leading Russian oil producer and one of the Russia's most transnational companies, **Lukoil**, operates extensive production, refining, and retail networks in the CIS. Lukoil is also the leading company in the Belarusian oil sector. Providing nearly 15% of Belarusian oil imports, the company is the largest single supplier of oil to the country. In equity investments, Lukoil owns 52 petroleum stations in Belarus through its subsidiary, Lukoil-Belarus.

In May 2006, Lukoil announced plans to form a joint venture with a Belarusian partner for the production of additives to engine oils (Belarus News... 2006a). According to repetitious statements by the Belarusian President in 2006, Lukoil was welcomed to expand its operations in Belarus beyond only operating the network of petroleum stations in the country. In the same vein, Lukoil was invited to expand its equity investments in the country. The deteriorated relations between the two nations at the end of 2006, however, have reportedly prevented further negotiations on the issue. Nevertheless, it remains obvious that Lukoil, keen to expand its refining capacity near the end markets of the EU, would be more than interested in wrestling control over Belarusian oil refining and infrastructure assets.

### **3.3. Mobile telecommunication**

Russia's largest telecommunication service provider, **Mobile TeleSystems (MTS)**, expanded its operations to Belarus in 2002 through a 49%-participation in a joint venture MTS Belarus. The controlling stake of 51% in the company is held by the Belarusian state-owned company Intercity Communications. At the end of 2005, the value of MTS' equity investment in Belarus totalled over USD 100 million with prospective investments in 2006 amounting to additional USD 100-150 million.

With nearly 2.5 million subscribers, MTS Belarus is the market leader in the country. In 2006, the company's Belarusian subscriber base grew by one quarter. Due to entries of two competitors on the market in the end of 2005, the market share of MTS Belarus diminished from 50% to around 40% during 2006. At the end of 2006, the mobile penetration rate in Belarus was 50%, which, although low on Western European standards, is considerably higher than in most of the CIS. For MTS, thus, the Belarusian market primarily offers growth possibilities in the value added services, rather than through explosive growth in subscriber base as is the case on many other immature CIS markets.

As the telecommunication sector in Belarus has tradition of heavy regulation, the operations of foreign companies have, in large extent, been dependent on the attitude of the government (Lisitsyn et al. 2005). Previously, no foreign majority ownership has been allowed in Belarusian telecommunication sector. During 2007, however, the antimonopoly legislation in the Belarusian telecommunication sector is expected to take effect, after which MTS is likely to seek the controlling stake in MTS Belarus. The move was pre-approved by the Belarusian Communications Ministry already in the beginning of 2006.

MTS is not the only Russian telecommunication company that has sought to tap the Belarusian markets. Back in 2004, both VimpelCom and MegaFon, the second and third largest telecommunication companies in Russia, participated in a tender for 49% in a new telecommunication joint venture with the Belarusian fixed-line monopoly, Beltelecom. Although the tender was eventually won by another Belarusian state-owned company, VimpelCom has repeatedly announced its interest in the country's mobile telecommunication sector. Prospective future privatisations of the Belarusian telecommunication assets could provide an option for the company to expand its operations to this market.

### **3.4. Other sectors**

The Russian investments in other sectors of the Belarusian economy are rather limited. Besides oil, natural gas, and telecommunication, the Russian companies have invested in the Belarusian food, chemical, and textile industries. In many occasions, the investments

date back to the Soviet era, meaning that the Belarusian assets were inherited by the present-day Russian companies after the disintegration of the Soviet Union.

In addition, the more unconventional sectors of the Belarusian economy, such as the newsprint industry, have accommodated Russian investments. To a limited extent, also the Russian information and communication technology (ICT) companies have outsourced their operations in Belarus. Despite the limited investments thus far, however, the Belarusian ICT sector has a potential of becoming a promising outsourcing market for the Russian (and the European) ICT companies due to its relatively mature technical infrastructure, reputable educational system, and proximity to the EU markets.

The advantageous geographical location of Belarus has attracted additional investments from the Russian transportation companies. Amidst the recent developments in the Russian-Belarusian relationships, the strategic importance of the Belarusian rail and road transportation assets is likely to increase, and along with it the interest of the Russian companies towards the sector.

Besides the industrial companies, the Belarusian banking sector is likely to attract considerable Russian interest in the upcoming years. The leading Russian banks have in several occasions announced their interest to increase their so far limited participation in the Belarusian banking sector in the event of privatisation of the country's banking assets.

#### **4. Conclusions and future implications**

Russia is the largest foreign investor in Belarus with a share of up to 80% of the Belarusian annual FDI inflows during the recent years. Despite their high share in Belarusian inward FDI, the Russian investments in the country have remained relatively modest compared to those in many other CIS countries. The largest Russian investments in Belarus are in oil, natural gas, and telecommunication sectors. Until now, virtually no major acquisitions by Russian energy companies serving Russia's foreign policy objectives have been witnessed in Belarus due to the traditionally close economic and political relationships between the two countries. The recent energy dispute and subsequent

deterioration of the relationships between Russia and Belarus, however, are likely to yield more strategic acquisitions by Russian companies in Belarus. As a part of the bitter solution for the energy dispute, Gazprom already wrestled control over 50% of the Belarusian national gas pipeline network, Beltransgaz.

The embedded USD 2.5 billion acquisition of this single most valuable industrial asset of Belarus by the Russian gas giant marks a clear change in Russian policies towards its most reliable ally in the former Soviet bloc. Apparently, the new reality sees the dominance of economic priorities over the political ones. The days of political rhetoric determining the relations between the two countries are evidently over as Russia fruitlessly deemed the actual implementation of the terms of the Union State agreement from Belarus. Blaming the Belarusian President Lukashenko for not living up to the promises made on harmonising the economies of the two countries, Russia eventually exerted its political influence through its most powerful bearer, Gazprom. The latest dispute only confirms the tendency that has been visible in Russia's foreign economic policy for already some time now – maximising the country's international competitive advantage and political leverage by employing its most powerful asset, the energy resources.

Despite the seemingly beneficial agreement on gas prices, the future for Gazprom's operations in Belarus remains far from secure. The Belarusian Government retained control over 50% of Beltransgaz, leaving room for unexpected future policy decisions regarding foreign ownership similar to those recently witnessed in the Russian oil and gas sector. In addition, Belarus will remain one of the key transit regions for its natural gas deliveries for years to come, since the Nord Stream pipeline in construction under the Baltic Sea will only be operational by 2010 at best. Moreover, the plans of constructing the second section of the Yamal-Europe pipeline on Belarus territory appears increasingly complicated in the face of the recent rent demands by Belarus on the assets on its soil.

In the oil sector, the future of rising export duties on the Russian crude sold to Belarus foresees considerable economic challenge for Belarus, but also for the Russian oil companies. In case the oil supplies to Belarusian refineries are cut as a result, the Belarusian budget revenues will diminish even further. Nevertheless, around one third of the Russian oil exports continue to flow through the Belarusian territory (Druzhba pipeline).

The planned expansion of Baltic Sea Pipeline and the Primorsk seaport on the Baltic shore are to decrease the Russian dependency on Belarus transit, but do not provide an immediate alternative to oil deliveries to the Western European customers through Druzhba pipeline.

As indicated by the above examples, the complicated mutual dependency of Belarus and Russia on their key economic sectors promises no simple solution for the confrontation. In the event of increasing distrust between the two countries, it is likely that Russia will look to strengthen its economic leverage in Belarus through acquisitions of strategic assets in the country. On the other hand, the Russian companies will face considerable political resistance in Belarus, compared to the previously welcoming atmosphere. Although the effects of the deteriorated relationships hit hardest the Russian energy companies, the entrance of Russian firms to other strategic sectors of the economy, such as telecommunication, is also likely to be banned for time being.

From the European viewpoint, the increasing Russian business presence in Belarus holds increasing stabilisation on one hand, but increasing dominance of Russia over its energy supplies, on the other. However, the growing uncertainty over Russian energy deliveries and supply disruptions similar to those witnessed in the beginning of the previous years, are hardly in the interest of the EU. In this context, the key issue to be considered by the European policy-makers is at which point does the stability provided by Russia's control over its energy supplies and assets in the region turn into economic and political supremacy.

## References

- Central Bank of Russia (2007). <http://www.cbr.ru>.
- Goskomstat (2007). <http://www.gks.ru>.
- Guide.Export.By (2007). <http://www.export.by>.
- Heinrich, A. (2003). "Internationalisation of Russia's Gazprom", *Journal of East European Management Studies*, 8 (1), pp. 46-66.
- Lisitsyn, N., Sutyurin, S.F., Trofimenko, O.Y., and Vorobieva, I. V. (2005) Outward Internationalisation of Russian Leading Telecom Companies. Pan-European Institute, Turku School of Economics, <http://www.tse.fi/pei/pub>.
- Liuhto, K. and Jumpponen, J. (2003a). *Russian Eagle Has Landed Abroad. Evidence Concerning the Foreign Operations of Russia's 100 Biggest Exporters and Banks* (Lappeenranta: Lappeenranta University of Technology).
- Liuhto, K. and Jumpponen, J. (2003b). "Russian Corporations and Banks Abroad", *Journal of East European Management Studies*, 8 (1), pp. 25-44.
- Ministry of Statistics and Analysis of the Republic of Belarus (2007). <http://www.belstat.gov.by>.
- National Bank of Belarus (2007). <http://www.nbrb.by>.
- ReAKKT (2007). The last minute gas deal. <http://www.reakkt.com>.
- RIA Novosti (2007a). Energy subsidies for Belarus to hit US \$ 5.8 bln in 2007 – Putin, 15.01.2007. <http://www.rian.ru>.
- RIA Novosti (2007b). Lukashenko accuses Russia of attacking his country, 30.01.2007. <http://www.rian.ru>.
- UNCTAD (2006a). *World Investment Report 2006: FDI from developing and transition economies: implications for development* (New York and Geneva: United Nations).
- UNCTAD (2006b). Cross-border M&A database, <http://www.unctad.org>.
- Vahtra, P. and Liuhto, K. (2004). *Expansion or Exodus? – Foreign Operations of Russia's Largest Corporations*, Pan-European Institute, Turku School of Economics, <http://www.tse.fi/pei/pub>.
- Vahtra, P. (2005). *Russian Investments in the CIS – Scope, Motivations, and Leverage*, Pan-European Institute, Turku School of Economics, <http://www.tse.fi/pei/pub>.
- Vahtra, P. (2006) *Expansion or Exodus? – Trends and Developments in Foreign Investments of Russia's Largest Industrial Enterprises*, Pan-European Institute, Turku School of Economics, <http://www.tse.fi/pei/pub>.



# **Ukraine-Belarus economic relations**

Iurii Bazhal

## **Contents**

1.	Introduction	152
2.	A comparison of macroeconomic performance in Belarus and Ukraine	153
3.	Bilateral trade	156
4.	Bilateral direct investments	158
5.	Bilateral tourism	159
6.	Conclusions	161
	Appendix	162

## 1. Introduction

Ukraine and Belarus are relatively similar in terms of their economic transformation<sup>1</sup>. Both of these countries had earlier high industrial and R&D potential, but nowadays the majority of their industrial enterprises are very large and have over costly production. During the transition period those enterprises, that did not lose their demand, have gained the leading role in the country's economic development and foreign trade<sup>2</sup>.

The economic transformation in the 1990s led to the GDP fall, huge inflation, decrease in the living standard for the majority of people, and the ineffective exports<sup>3</sup>. The economic growth has taken place in both countries, however, without a major structural shift in economic structures<sup>4</sup>.

Another common feature in Ukraine and Belarus is huge gas and oil dependence on Russia. During the entire transition period, energy prices imported from Russia have been considerably below the world market level, and thus, these energy deliveries have supported the existence of the old 'Soviet-type' industrial enterprises. Their export potential was backed by artificially low energy prices that mitigated outdated energy intensive technology.

Russia's President Vladimir Putin estimates that Russia subsidises Belarus in 2007 with USD 5.8 billion (USD 2.5 billion with oil and USD 3.3 billion with gas deliveries) that equals to nearly 41% of the consolidated budget of Belarus in 2007<sup>5</sup>. In smaller scale but in no less critical meaning, this also concerns Ukraine.

The Ukrainian and Belarusian roads to a market economy differ. Ukraine has chosen

---

<sup>1</sup> Market transformation of post-socialist economy and macrostructural shifts in Ukraine (analytical report) // National Security & Defence, 2003, № 4. – P. 20. International Yearbook of Industrial Statistic 2006. – Vienna, UNIDO, 2006. – Table 1.4.

<sup>2</sup> Business in Belarus 2006: Status, Trends, Perspectives. Analytical report. - Minsk, IPM Research Center, 2006. <http://research.by/pdf/Business2006e.pdf>

<sup>3</sup> Transition - The First Ten Years, Analysis and Lessons for Eastern Europe and the Former Soviet Union, The World Bank, 2002.

<sup>4</sup> Багал Ю.М. Інвестиційний ресурс інноваційного розвитку / В кн.: Інноваційний розвиток економіки: модель, система управління, державна політика. - Київ, Основа, 2005.

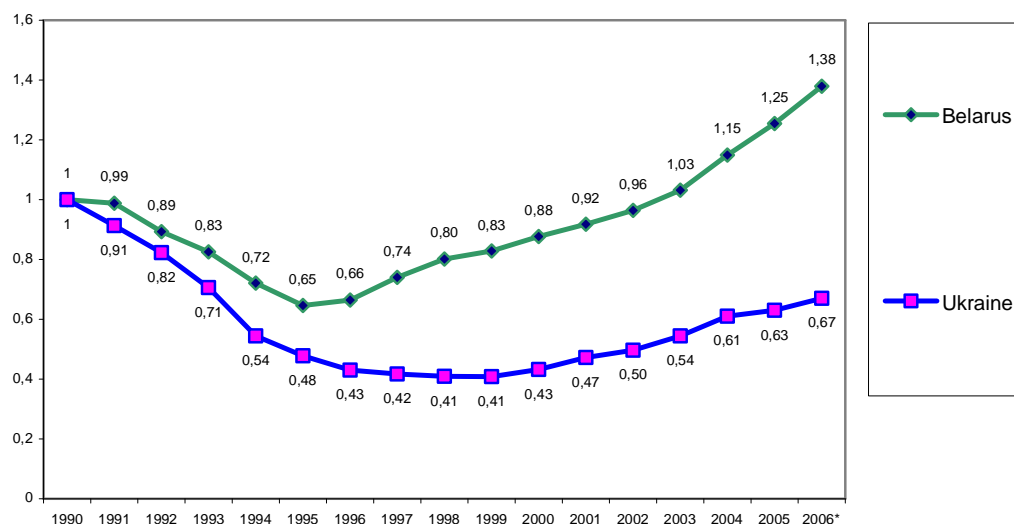
<sup>5</sup> Address of President Vladimir Putin to the Russian Federation Government, January 15, 2007 Новый Портал <http://np.by>, 15.01.2007 // Экономика.

'oligarchy capitalism', whereas Belarus 'state capitalism'. Both of these systems restrain the power of market regulation. Another difference; in Ukraine the democracy has been kept, in Belarus the authoritarian state prevails.

## 2. A comparison of macroeconomic performance in Belarus and Ukraine

The GDP development both in Ukraine and in Belarus demonstrates a trend that is typical for all economies in transition: a catastrophic fall at the beginning of the reform, which is followed by a recovery (see Figure 1)<sup>6</sup>.

**Figure 1. The real GDP development in Belarus and Ukraine (1990 = 1)**



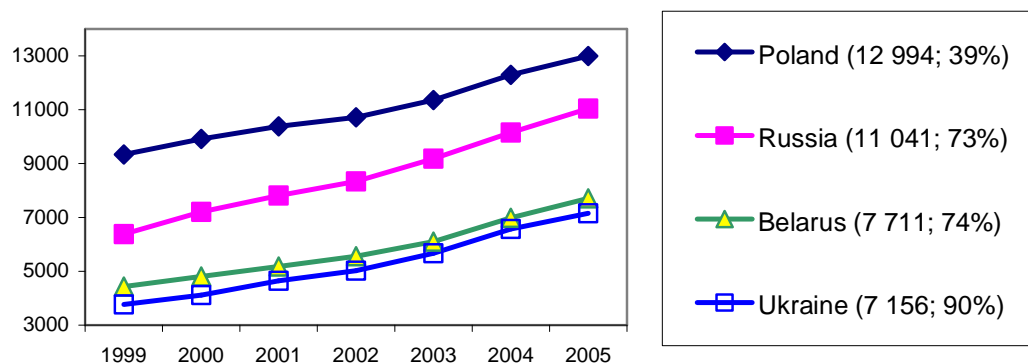
Source: State Statistic Committees of Ukraine and Belarus.

Ukraine experienced a shock therapy during 1991-1999 when it lost more than a half of its GDP. The fall of the Belarusian GDP was four years shorter but also very deep. The common consequences of the transition were high inflation, swift decrease of internal consumption, depreciation of labour force cost, relative growth of international trade, and devaluation of currencies in both countries. Also the economic recovery occurred in

<sup>6</sup> Havrylyshyn, Oleh. Recovery and Growth in Transition: A Decade of Evidence, IMF Staff Papers, 2001, Vol., 48, pp. 53–87. Fischer, S., and R. Sahay, The Transition Economies after Ten Years, IMF Working Paper, 2000, No. 00/30, Washington, D.C.: IMF.

principle in a similar manner<sup>7</sup> (see Figure 2).

**Figure 2. The development of GDP per capita at PPP (USD; change since 1999)**



Source: New Europe: Report on Transformation, XIV Economic Forum, Krynica, Poland, September 6-9, 2006, Fifth Edition, Warsaw, Eastern Institute, 2006.

The foreign trade has occupied an important place in both countries. Both exports and imports account for about a half of their GDP (see Table 1).

**Table 1. The share of exports and imports in the Belarusian and Ukrainian GDP**

	2000	2001	2002	2003	2004	2005
<b>Belarus</b>						
Exports	58%	60%	61%	56%	60%	54%
Imports	68%	67%	69%	65%	71%	56%
<b>Ukraine</b>						
Exports	46%	43%	42%	46%	47%	42%
Imports	44%	42%	40%	46%	44%	44%

Source: New Europe: Report on Transformation, XIV Economic Forum, Krynica, Poland, September 6-9, 2006, Fifth Edition, Eastern Institute, 2006, p. 226, 289.

The high economic growth in Belarus has decreased the shares of exports and imports in its GDP despite the increase in foreign trade turnover. In Ukraine, the respective share has remained rather stable. The table above show that the popular view about Belarus being a closed economy turns out to be a myth. In a similar tone, IMF experts Willy Kiekens (Executive Director for Republic of Belarus) and Mikhail V. Nikitsenka (Advisor to

<sup>7</sup> Belarus: Window of Opportunity to Enhance Competitiveness and Sustain Economic Growth, Country Economic Memorandum for the Republic of Belarus, Executive Summary, The World Bank, Report No. 32346-BY, November 8, 2005.

Executive Director) have concluded that the Belarusian GDP growth is mainly export-driven, and that Belarus is now the most open economy among CIS countries (see Table 2)<sup>8</sup>.

**Table 2. The foreign trade of Belarus and Ukraine (USD billion)**

	2000	2001	2002	2003	2004	2005
<b>Belarus</b>						
Exports	7.3	7.5	8.0	9.9	13.8	16.0
Imports	8.6	8.3	9.1	11.6	16.5	16.7
<b>Ukraine</b>						
Exports	14.6	16.3	18.0	23.1	30.7	34.3
Imports	14.0	15.8	17.0	23.0	29.0	36.1

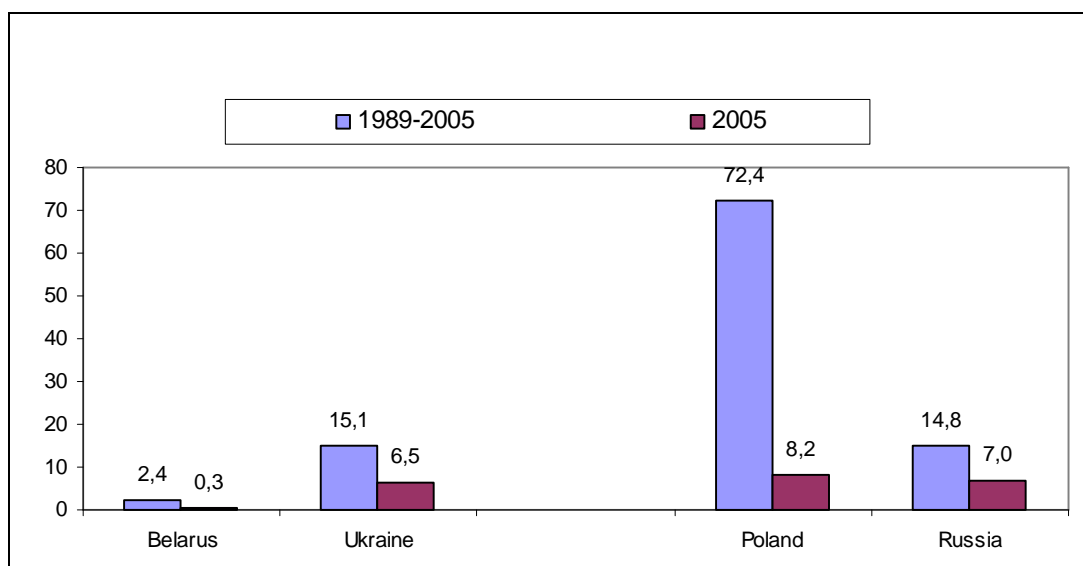
Source: Commonwealth of Independent States in 2005, Concise abstract / Interstate Statistical Committee of the CIS, M., 2006, p. 280, 426.

The geographical division of the Belarusian foreign trade has changed. In 2000, 60% of its foreign trade was conducted with other CIS countries, whereas five years later, the CIS accounted for 44% of its foreign trade. In Ukraine, the geographical shift has been less notable. In fact, the exports to the CIS made 31% both in 2000 and 2005. In the import side, the change is more visible. In 2000, 58% of the Ukrainian imports came from other CIS countries, whereas in 2005 just 47%<sup>9</sup>. When foreign direct investment inflows to Belarus and Ukraine are analysed, one can easily discover that the foreign investment are almost absent in the Belarus economy (see Figure 3).

---

<sup>8</sup> IMF Executive Board Concludes 2006 Article IV Consultation with the Republic of Belarus, Public Information Notice (PIN) No. 06/101, August 25, 2006.

**Figure 3. Net foreign direct investment in Belarus and Ukraine (USD billion)**



Source: New Europe: Report on Transformation, XIV Economic Forum, Krynica, Poland, September 6-9, 2006, Fifth Edition, Warsaw, Eastern Institute, 2006, p. 117-118.

### 3. Bilateral trade

The trade relations between Belarus and Ukraine are not particularly intensive (see Table 3).

**Table 3. The Ukrainian foreign trade with Belarus and Belarus' share in the foreign trade of Ukraine in 2005**

Ukraine-Belarus	Exports		Imports	
	USD million	Belarus' share of total	USD million	Belarus' share of total
<b>Commodities</b>	891.1	2.6%	939.8	2.6%
<b>Services</b>	47.3	0.8%	23.8	0.8%

Source: Зовнішня торгівля товарами та послугами у 2005 році, Статистична збірка, Т. 1., Київ, Держкомстат, 2006, р. 37, 107.

If we analyse the bilateral trade from Belarus' perspective, the corresponding figures of the Belarusian trade with Ukraine we can be found in Table 4.

<sup>9</sup> Commonwealth of Independent States in 2005, Concise abstract / Interstate Statistical Committee

**Table 4. The Belarusian foreign trade with Ukraine and Ukraine's share in the foreign trade of Belarus in 2005**

Belarus-Ukraine	Exports		Imports	
	USD million	Ukraine's share of total	USD million	Ukraine's share of total
<b>Commodities</b>	907.8	5.7%	893.9	5.4%

Source: Внешняя торговля республики Беларусь за 2005 год (предварительные данные), Минск, Министерство статистики и анализа Республики Беларусь, 2006, p. 18-19.

The share of Belarus in foreign trade of Ukraine is small, whereas the share of Ukraine in the Belarusian foreign trade is twice higher, but anyway it also remains rather small. While have concluded the aforementioned, it is essential to note that the bilateral trade between Belarus and Ukraine has increased rapidly. In 2005, the Belarusian exports to Ukraine grew by 1.7 times and imports by 1.6 times. Table 5 describes the geographical division of the Belarusian foreign trade.

**Table 5. The geographical division of the Belarusian foreign trade in 2005**

	Total		CIS countries		Ukraine		Russia		Countries outside the CIS	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
Belarus' foreign trade, USD million	15,977	16,699	7,058	11,118	908	894	5,714	10,094	8,919	5,581
Structure	100%	100%	44%	67%	6%	5%	36%	60%	56%	33%
Change between 2004-5	16.0%	1.3%	-3.5%	-6.4%	68.2%	64.0%	-11.9%	-10.0%	38.2%	21.1%

Source: Внешняя торговля республики Беларусь за 2005 год (предварительные данные). Минск, Министерство статистики и анализа Республики Беларусь, 2006, p. 18-19.

In 2005, a significant geographical shift in the Belarus foreign trade occurred. The trade flows moved from Russia and other CIS countries (excluding Ukraine) to Ukraine and the countries outside the CIS. For a closer analysis, see Appendix.

---

of the CIS, Moscow, 2006, p. 117-118.

#### 4. Bilateral direct investments

The bilateral investments flows between Belarus and Ukraine are insignificant. Table 6 describes the Belarus direct and portfolio investments to Ukraine during 2000-2005.

**Table 6. Annual investment flows from Belarus to Ukraine (USD million)**

	2000	2001	2002	2003	2004	2005
Direct investment	0.120	0.05	-0.500	-1.22	-0.06	0.280
Portfolio investment	0.004	0.28	-0.003	0.00	0.00	-0.002

Source: National Bank of the Republic of Belarus.

Table 7 describes the direct investments from Belarus to Ukraine in terms of field of activity. In 2006, the accumulated stock of the Belarusian direct investments in Ukraine decreased by 11% from USD 19 million to USD 17 million. The drop was mainly due to the health care sector, since the sector lost a half of its foreign capital assets. Despite the drop, the health care sector occupied the second place with USD 3.4 million after the industry.

**Table 7. Direct investments from Belarus to Ukraine in 2006**

	At the beginning of the year	At the end of the year	Change during the year	Annual growth, %
	USD million			
TOTAL	19.12	16.94	-2.18	-11.4%
AGRICULTURE	0.21	0.34	0.13	63.5%
INDUSTRY	7.77	8.61	0.84	10.7%
Mining	5.42	6.17	0.76	14.0%
Manufacturing	5.42	6.17	0.76	14.0%
Food industry	0.59	0.63	0.04	7.2%
Engineering	1.60	1.61	0.00	0.0%
CONSTRUCTION	0.01	0.13	0.12	1322.1%
TRADE	1.19	1.30	0.11	9.5%
HOTEL AND RESTAURANTS	0.12	0.12	0.00	0.0%
TRANSPORT AND COMMUNICATIONS	2.22	2.22	0.01	0.2%
REAL ESTATE	0.49	0.85	0.36	74.3%
HEALTH CARE	7.12	3.38	-3.74	-52.6%

Source: Інвестиції зовнішньоекономічної діяльності у 2006 році, Статистичний бюлетень, Київ, Держкомстат, 2007, р. 172.



The direct investments from Ukraine to Belarus made up only 4% of the Belarusian investments to Ukraine. The Ukrainian direct investment in Belarus amounted to only USD 0.7 million at the end of 2006 (see Table 8).

**Table 8. Direct investments from Ukraine to Belarus in 2006**

	At the beginning of the year	At the end of the year	Change during the year	Annual growth
	USD million			
<b>TOTAL</b>	<b>0.703</b>	<b>0.713</b>	<b>0.010</b>	<b>1.5%</b>
<b>INDUSTRY</b>	<b>0.344</b>	<b>0.064</b>	<b>-0.279</b>	<b>-81.3%</b>
<i>Manufacturing</i>	0.344	0.064	-0.279	-81.3%
Chemicals and petrochemicals	0.040	0.020	-0.020	-50.0%
Engineering	0.304	0.044	-0.259	-85.4%
<b>CONSTRUCTION</b>	<b>0.020</b>	<b>0.020</b>	<b>0.000</b>	<b>0.0%</b>
<b>TRADE</b>	<b>0.060</b>	<b>0.360</b>	<b>0.299</b>	<b>497.5%</b>
<b>TRANSPORT AND COMMUNICATIONS</b>	<b>0.014</b>	<b>0.014</b>	<b>0.000</b>	<b>0.4%</b>
<b>FINANCIAL ACTIVITY</b>	<b>0.117</b>	<b>0.117</b>	<b>0.001</b>	<b>0.4%</b>
<b>REAL ESTATE</b>	<b>0.125</b>	<b>0.137</b>	<b>0.012</b>	<b>9.3%</b>
<b>HEALTH CARE</b>	<b>0.022</b>	<b>0.000</b>	<b>-0.022</b>	<b>-100.0%</b>

Source: Інвестиції зовнішньоекономічної діяльності у 2006 році. Статистичний бюлетень. - Київ, Держкомстат, 2007. - Р. 191-192.

Ukraine is a net importer of the direct investments from Belarus with a sum of USD 16 million. Only three sectors of the Belarus economy are the net importers of the Ukrainian direct investments, namely construction, financial activity, and chemical and petrochemical industry. The small inflows of the foreign direct investments to Belarus, including those from Ukraine, show that the foreign investors do not have a particular interest in investing money into an economy with strong governmental control.

## 5. Bilateral tourism

Tourism has a lot of potential in the bilateral economic relations between Belarus and Ukraine. Unfortunately, the tourism potential between Belarus and Ukraine remains

unused. Table 9 shows that the border crossings between Ukraine and Belarus grew by 20% during 2000-2005. During the same period, all the border crossings of Ukraine increased twice faster (42%), indicating a relatively low interest of the Ukrainians to travel to Belarus.

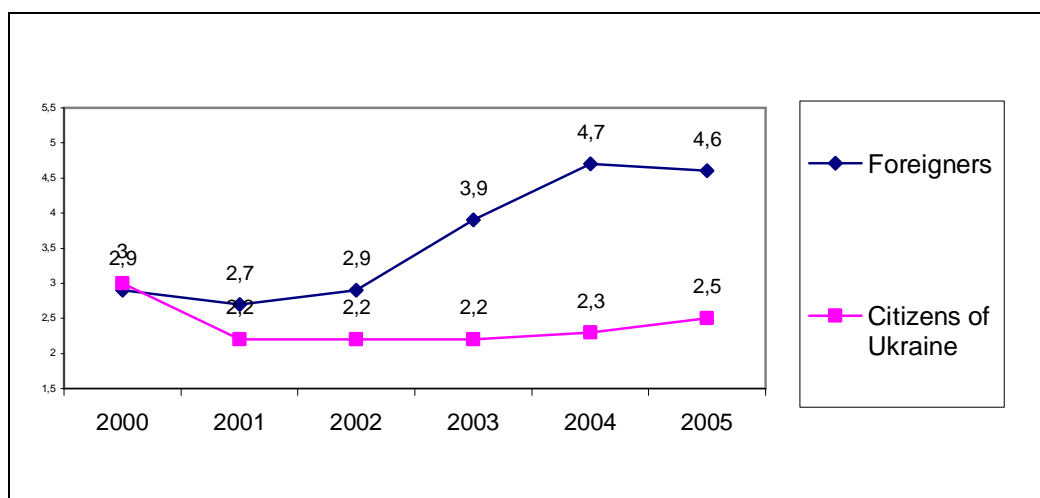
**Table 9. The development of the border crossings between Ukraine and Belarus (million persons)**

	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>
All border crossings of Ukraine	51.5	53.8	55.4	60.3	67.0	73.2
Border crossing between Ukraine and Belarus	5.9	4.9	5.2	6.1	7.1	7.1
Share of the Belarusian frontier	11.5%	9.1%	9.4%	10.1%	10.6%	9.7%

Source: Туризм в Україні, Статистичний збірник, Київ, Держкомстат, 2006, р. 23.

The increase in the border crossings between Belarus and Ukraine is mainly due to the increased travelling of the foreigners to Belarus via Ukraine (see Figure 4).

**Figure 4. The border crossings between Belarus and Ukraine (million persons)**



Source: Туризм в Україні, Статистичний збірник, Київ, Держкомстат, 2006, р. 23.

The bilateral tourism business between Belarus and Ukraine has developed on an old 'Soviet' base. If new tourism attractions are not developed, it will be hard to develop the tourism between Belarus and Ukraine.

## 6. Conclusions

The remarkable growth of the trade between Ukraine and Belarus during 2005-2006 reflects the positive economic development of these countries. Despite the growth, the trade is still modest. In 2005, the share of Belarus in the Ukrainian exports and imports was 2.6%. Correspondingly, the share of Ukraine in the Belarusian exports was 5.7%, and in imports 5.4%. Such low shares indicate that the former Soviet republics do not have particular incentives to co-operate. Only the fuel and energy sector has remained the core of the CIS economic integration. This applies also to the bilateral relations between Belarus and Ukraine.

In mid run, we do not expect a fundamental change in the bilateral trade between Belarus and Ukraine or its structure. The bilateral trade most likely increases, unless the governments of both countries start to build the knowledge-based societies. If such reforms will happen, it creates a fruitful base to develop bilateral economic relations in the Eurointegration context.

**Appendix: The Belarusian exports to Ukraine in 2005 (USD million)**

	<b>Total</b>	<b>Ukraine</b>	<b>Ukraine's share of total</b>	<b>CIS countries</b>	<b>Countries outside the CIS</b>
Mineral products	5 655.7	225.3	4.0%	354.8	5 300.8
Means of transportation	1 656.9	172.1	10.4%	1 339.0	317.9
Machine building	1 434.5	138.3	9.6%	1 262.1	172.4
Plastic and rubber manufactures	531.5	76.8	14.5%	423.5	108.0
Textile manufacture	936.7	54.3	5.8%	550.3	386.4
Chemical industry	1 535.8	51.8	3.4%	234.4	1 301.4
Ready-made foodstuffs	542.8	49.6	9.1%	466.9	75.9
Construction materials	349.4	34.6	9.9%	290.3	59.0
Metallurgy	638.0	28.8	4.5%	251.7	386.3
Paper products	166.3	24.5	14.8%	154.3	12.0
Other industrial production	355.0	8.1	2.3%	281.1	73.9
Timber and its products	392.4	6.7	1.7%	114.6	277.7
Plant cultivation	62.2	5.1	8.2%	31.3	30.9
Cattle breeding	706.5	3.7	0.5%	699.0	7.6
Raw stock, leather, furs	81.0	2.9	3.6%	34.2	46.8
Equipments and devices	148.8	2.1	1.4%	60.0	88.9
Manufacture of shoes and hats	86.8	1.2	1.4%	73.9	9.2
Vegetable fats	17.9	0.0	0.3%	7.6	10.3

Source: Внешняя торговля республики Беларусь за 2005 год (предварительные данные), Минск, Министерство статистики и анализа Республики Беларусь, 2006, р. 18-35.

**Appendix: The Belarusian imports from Ukraine in 2005 (USD million)**

	<b>Total</b>	<b>Ukraine</b>	<b>Ukraine's share of total</b>	<b>CIS countries</b>	<b>Countries outside the CIS</b>
Metallurgy	1 910.5	273.6	14.3%	1 603.9	306.6
Machine building	2 584.5	193.8	7.5%	978.6	1 605.9
Ready-made foodstuffs	904.5	101.0	11.2%	477.0	427.5
Chemicals	1 159.9	80.1	6.9%	488.2	671.7
Means of transportation	970.5	50.9	5.2%	300.4	670.2
Plant cultivation	377.8	36.3	9.6%	167.8	210.0
Plastic and rubber manufactures	794.8	33.9	4.3%	403.3	391.5
Vegetable fats	128.8	24.3	18.9%	110.5	18.2
Mineral products	5 617.9	20.4	0.4%	5 567.2	50.8
Construction materials	201.0	14.9	7.4%	105.4	95.5
Paper products	288.9	14.7	5.1%	184.8	104.1
Textile manufacture	475.4	14.6	3.1%	186.2	289.2
Equipments and devices	264.9	14.1	5.3%	69.9	195.0
Timber and its products	98.7	9.2	9.3%	36.0	62.7
Other industrial production	108.5	4.0	3.7%	42.6	65.8
Raw stock, leather, furs	81.7	3.1	3.8%	52.5	29.3
Manufacture of shoes and hats	147.9	2.0	1.3%	135.7	12.2
Cattle breeding	376.4	0.7	0.2%	118.2	258.2

Source: Внешняя торговля республики Беларусь за 2005 год (предварительные данные), Минск, Министерство статистики и анализа Республики Беларусь, 2006. р. 18-35.

# **A growth triangle between Belarus, Poland and Ukraine: A challenge for cross-border integration at regional level**

Janek Uiboupin<sup>1</sup>

## **Contents**

1.	Introduction	165
2.	A literature review about cross-border co-operation and regional development	166
3.	An overview of regions in the growth triangle	168
3.1.	The Brest region as a border region	168
3.2.	The Lubelskie Voivodship as a border region	170
3.3.	The Volyn region as a border region	172
4.	Cross-border co-operation between the Brest region, the Lubelskie Voivodship and the Volyn region	174
4.1.	An overview of the Bug Euroregion	174
5.	Main problems, opportunities and solutions of the growth triangle	176
6.	Conclusions	179
	References	181

---

<sup>1</sup> Financial support from the Academy of Finland is greatly acknowledged.

## **1. Introduction**

The EU enlargement and the emergence of new Europe have created a challenging opportunity to Eastern European transition countries for the support of economic and especially regional development. Peripherality is the well-known problem of border regions and there is a wide discussion in the regional development literature about the possibilities to reduce these regional disparities, several programmes have proposed for that purpose. The cross-border co-operation is one of the most recognised and discussed ways to develop border regions (Baldwin and Forslid, 1999; Brodzicki, 2002; Pitoska, 2006). The growth of international trade and technology transfer that follows foreign direct investments is also found to be very important in the development of border regions. In 2007, the European Neighbourhood Policy (ENP) started to replace former cross-border co-operation programmes. One of the main goals of the ENP is to intensify cross-border co-operation between EU border regions and their neighbouring regions. Since May 2004, Belarus has direct border connections with three EU member countries – Latvia, Lithuania and Poland. The proximity of the EU creates several challenges for Belarusian economic development.

The aim of this article is to characterise the main development factors of Brest, Volyn and Lubelskie border regions and to find out possibilities to increase domestic and international competitiveness of these regions through intensified cross-border co-operation.

The rest of the article is structured as follows. In Chapter 2, a literature overview about main studies in cross-border co-operation and regional development is given. In Chapter 3, a study of socio-economic development in the Brest region, the Lubelskie Voivodship and the Volyn region is carried out. Chapter 4 and Chapter 5 analyse the current situation, problems, opportunities and solutions in cross-border between the regions while Chapter 6 gives some concluding remarks.

## **2. A literature review about cross-border co-operation and regional development**

Cross-border co-operation as a tool for regional development has got more attention since the middle of the 1990s. The EU enlargement process raised also an issue of regional development and regional integration. There are several theoretical and empirical studies conducted in that field lately. One of the most cited theories of regional co-operation and development is the core-periphery model.

The core-periphery model, the grounding of new economic geography was first introduced by Krugman (1991). It describes the interactions between increasing returns to scale of firms, transport costs and factor (labour) mobility and how they can cause and develop spatial structure of economic development. Baldwin and Forslid (1999) have integrated new growth theory with the new economic geography model suggested by Krugman (1991). They showed that growth can be destabilising force while inter-regional learning spill-over effects are stabilising. They also showed that the agglomeration of industry is enhancing growth in both core and peripheral areas.

The core-periphery theory is based on the fact that border regions are placed in peripheral regions. Erkut and Özgen (2003) analysed regional disparity of regions and countries using statistical data from NUTS II. Their conclusion is that there are significant regional differences in development and the core-periphery distribution of regions in economic development has increased after the EU enlargement. This result is also consistent with Brodzicki (2002). The border regions are found most distressed in their comparison in terms of infrastructure and economic development. They suggest that cross-border co-operation is an essential way to reduce regional underdevelopment of border regions.

Similar results were obtained by Petracos and Economou (2002) who concluded that the development gap between metropolitan regions and border regions is growing and there is need for policy actions towards enhance development and cross-border co-operation in border regions. Krätke (1998) distinguishes between low-road and high-road regional integration and stresses the importance of the quality of cross-border co-operation. He also puts the problem of regional development in the light of exogenous and endogenous impact on regional development. The study was carried out based on German-Polish



border regions. The conclusion was that the regional integration tends to be low level, because no trans-border economically integrated region could be identified.

Niebuhr (2005) analysed the effect of EU27 enlargement on the economic development of the EU border regions. A three region economic geography model was used as a starting point of the research. Regression analysis combined with the simulation technique was used to estimate the impact of change in market access on the per capita GDP of border regions. The results indicate that the integration effects of change in market access are even stronger than predicted by the theoretical framework.

Houtum (1998) analysed the effect of state border on the cross-border economic relationships. The theoretic model was proposed to distinguish between different stages of cross-border co-operation. The main stages of cross-border relations of firms were: contact, attraction, interaction, transaction and relationship. The model was tested on large sample of firms of Dutch-Belgian border regions. The empirical results of the paper showed that the similarity and trust were the most important factors for the success of cross-border relations of firms.

Topaloglou and Petrakos (2006) have shown based on EXLINEA framework used in Northern Greek border regions that the market size of border region and close distance of a large city are important factors of cross-border trade and investment flows of a border region. This result shows a positive correlation between success in cross-border co-operation and general economic and sociologic development of a border region.

Stiller (2003) has found that there is no significant difference between level of employment and population growth in border regions and in other regions of Poland and Germany. This result is indicating that border regions do not develop significantly differently because of cross-border integration between countries.

The growth triangle concept is another look on cross border regional integration. The first official growth triangle was announced in 1989 between incumbent regions in Singapore, Malaysia and Indonesia, called as the Southern growth triangle. Growth triangle is a cross-border economic zone including areas from three or more countries. The main positive

effects of a growth triangle are economies of scale and scope, growing agglomeration, transfer of technology, attracts foreign direct investments (Kivikari, 2001).

Besides a great optimism about positive effects of EU neighbourhood programmes on the development of border regions (TACIS, INTERREG III) there are also significant considerations about effectiveness of these programmes. Pitoska (2006) discussed based on the example of EU-Balkan co-operation that these programmes have positive but modest effect on the socio-economic development of border regions. Nevertheless, cross-border co-operation is seen as a possible tool for developing border regions.

In summary, there are several theoretical and empirical studies showing that the cross-border co-operation is one of the most effective tools for regional development policy. Nevertheless, there are many obstacles why the cross-border co-operation has not been very successful in some cases.

### **3. An overview of regions in the growth triangle**

#### **3.1. The Brest region as a border region**

The Brest Oblast, the Brest region, known as the Belarusian gateway to West, is situated at the South-Western part of Belarus. The regions borders with Poland in the west, Ukraine in the south Gomel region in the north and Grodno and Minsk region to the east. The capital of the Brest region is the Brest city. The city is located at the border of Poland, very suitable to develop cross-border relations. The population of region is approximately 1.5 million. 85% of the regions population are Belarusians, 13% Russians, 4% Ukrainians, and 2% Poles.

The Brest region has a good transport infrastructure. A transit corridor M1/E-30 Berlin-Warsaw-Brest-Minsk-Moscow is of top priority. About 80% of land exports of the CIS countries to Western Europe are transported through the region (Brest Regional Executive Committee, 2006).

The region occupies an important agrarian area of Belarus. Two thirds of meat and more than 70% of milk production of Belarus are produced in the region. The manufacturing sector of the region is also relatively well developed. The Brest region is also an important producer of press-forging equipment (90%), cotton fabrics (60%), knitwork, sugar and many other products of Belarus.

The industrial production growth if the Brest region is slightly above Belarusian average, 12% in 2005, about the same of growth in Minsk region. Table 1 indicates that Belarus has comparatively even regional industrial development.

**Table 1. Development of industrial production in Belarus (as % of previous year)**

	1995	2000	2001	2002	2003	2004	2005
<b>Belarus</b>	88	108	106	105	107	116	111
Brest	80	105	109	103	109	118	112
Vitebsk	90	107	103	103	106	112	110
Gomel	94	111	104	107	105	120	107
Grodno	98	103	103	102	107	111	111
Minsk City	82	114	110	108	110	119	112
Minsk	93	103	110	104	108	115	112
Mogilev	83	105	103	100	104	112	111

Source: The Ministry of Statistics and Analysis of the Republic of Belarus, 2006.

Table 2 gives an overview of some indicators of regional development in Brest in comparison with Belarus average indicators. The official unemployment of the Brest region is somewhat higher than average. According to Economist Intelligence Unit (2006), the actual unemployment in Belarus is about 5% higher than official statistics.

The growth of real income, investments and dwelling houses has been very similar to Belarusian average level. The agricultural production decreased by 2% in the Brest region while it increased by 2% in Belarus on average. Generally it can be said, that the economic development of the Brest region is fully comparable with other regions in Belarus and no peripheral position can be detected. It is likely, that the favourable geographical position of the region, good transport infrastructure and cross-border co-

operation have contributed significantly to the development of the Brest region and helps to avoid peripheral status.

**Table 2. Selected statistics of the Brest region and Belarus in 2005**

<b>Indicator</b>	<b>Brest</b>	<b>Belarus average</b>
Official unemployment (%)	1.8	1.5
Change in real income (%)	19	18
Growth of agricultural production (%)	-1.7	1.7
Growth of investments to fixed capital (%)	17	20
Dwelling houses (square meters per 1000 inhabitants)	390	387

Source: The Ministry of Statistics and Analysis of the Republic of Belarus, 2006.

In the second half of the 1990s, the first free economic zone (FEZ) in Belarus, the FEZ Brest was established. Today about 100 enterprises are operating in the Brest FEZ, more than USD 120 million of foreign direct investments were attracted by January 2006. The FEZ Brest is located at two transport areas in the Brest city on the area of 71 square km. The first area is located north-west of Brest at the Kukuryki-Kozlovichi truck border crossing check point. The second area is located east of Brest surrounding the functioning airport and adjoins the Berlin-Warsaw-Minsk-Moscow highway.

### **3.2. The Lubelskie Voivodship as a border region**

The total population of the region is about 2.2 million. The border length of the Lubelskie Voivodship with Belarus is 168 km and with Ukraine 277 km. The unemployment rate of the region was 15% as of November 2006. The unemployment of the region has decreased by 2% since December 2005. The total unemployment of Poland was 15% in November 2006.

The cross-border co-operation and economic relations between the Lubelskie region and neighbouring border regions have intensified since the EU enlargement. The total number of border crossings at the Polish border between Belarus and Ukraine have increased by more than 2.6 million in 2006 compared with 2005 (Table 3).

**Table 3. Border crossings at the Polish border (million persons)**

Period	Total border crossings		Departures of Poles		Arrivals of foreigners	
	Belarus	Ukraine	Belarus	Ukraine	Belarus	Ukraine
2005 I-XII	8.8	17.8	0.5	4.1	3.9	4.9
2006 I-III	2.0	4.3	0.2	1.0	0.9	1.1
2006 I-VI	4.4	9.2	0.3	2.2	1.9	2.4
2006 I-IX	7.2	14.6	0.6	3.5	3.0	3.9
2006 I-XII	9.8	19.4	0.8	4.6	4.1	5.2

Source: Central Statistical Office of Poland, 2007.

The number of border crossings at the Poland-Belarus border has increased by 11% and at the Poland-Ukraine border by 9%.

There are several strong and also negative aspects of regional development in the Lubelskie Voivodship for the cross-border co-operation. From the positive side, the Lubelskie Voivodship has good geographical position for cross-border trade and clean environment, the region is rich of mineral raw materials, the land has a lot of good soil areas. The region is also an important academic centre of South-East Poland and is rich with cultural heritage.

There are also several problems to develop cross-border co-operation in the Lubelskie region. The region has one of the lowest economic developments in Poland with high unemployment. Low level of urbanisation and agrarian overpopulation in rural areas does not support to develop investment climate in the region. The recreational and cultural facilities are poorly managed with outdated infrastructure. One of the major problems to develop cross-border co-operation is the bad shape of transportation network. There is no passenger airport and there is a lack of motorways border regions (Portrait of the regions, 2007).

Despite the EU membership of Poland, the Lubelskie region has comparatively few possibilities to develop cross-border co-operation with Belarus and Ukraine because of its low development. Nevertheless, the substantial financial support from the EU structural funds and EU Neighbourhood Programme would help to develop cross-border relations and economic development within the region.

### **3.3. The Volyn region as a border region**

The Volyn region is situated in North-West Ukraine. The Volyn region has the borderline with Poland and Belarus. The geographic position of the region favours the cross-border co-operation with the European Union and CIS countries. The total population of the Volyn region as of August 2006 was 1 million (Table 4). The total migration of the region has been positive during January-September 2006 unlike many other regions of Ukraine. The growth of industrial production of the region was 37% by July 2006 compared with same period in 2005.

There are nine border crossings operating in Volyn. The modernisation and renovation of border crossings is one of the priorities of the local government. Four border crossings are used for goods clearance at the Ukrainian-Polish border (Investment Attractiveness..., 2006).

Volyn has is well endowed with forest, land and recreational resources. Ukraine's most perspective deposits of copper have been found in the region with capacities of 7 million tonnes. In the northern part of the region deposits of phosphates have been found.

More than 55% of the industrial production of the region comes from food and food-processing industries. The machine-building, chemical and building materials industries are also well developed. An important part of the industrial production comes from wood industry and especially furniture industry that is an important export article of the region.

Volyn has 330 km of foreign frontier, including 135 km with Poland and 195 km with Belarus. Nine customs transition territories are located in Volyn: Ustilug, Yagodyn, Izov, Rymachi, Domanovo, Dolsk, Pishcha, Pulemets, and Zabolotta.

The total exports of the Volyn region in the first quarter 2006 were USD 57 million and imports USD 160 million. The import growth compared with the same period in 2005 was remarkable 21%, while export growth amounted only for 1%. The economic subjects of Volyn had trade relations with 59 countries, production was exported into 43 countries and

Volyn imported goods and services from 48 countries. The exports of the Volyn region accounted nearly 1% and imports 2% of Ukraine's total in January-March 2006.

**Table 4. The main economic indicators of the Volyn region**

	1.07.2006	Growth (%)
Industrial production (% growth compared with the same period in 2005)		37
Imports (USD million)	279	18
Exports (USD million)	138	0
FDI inflow (USD million)	18	260
GDP (in 2000 prices – UAH billion)	451	7
Bank credit (UAH million)	2085	71
Unemployed (1000)	23	- 6
Retail trade (UAH million)	1028	20
Monthly wage (UAH)	807	33
Agricultural production		7
Total population (million)	1039	

Source: Statistical office of Volyn Oblast, State Statistical Committee of Ukraine, 2006.

The majority of goods (58%) were exported into the EU member countries (USD 33 million), more than 25% of the exports went to the CIS countries (USD 17 million). Russia was the largest single export market for the Volyn region (USD 9 million), followed by Germany (USD 9 million) and Romania (USD 6 million). Neither Poland nor Belarus was among the top export markets for Volyn companies.

The main export articles of Volyn in the beginning of 2006 were machinery, electronics, wood products, oil products and metals. Substantial part (45%) of imported goods to Volyn came from Russia (USD 74 million), the imports from Korea was USD 29 million (18%) and from Poland USD 17 million (11%), Germany USD 8 million and from Belarus USD 6 million (3%).

The import structure was dominated by transport machines, oil and oil products, and electronics. There were 160 exporting firms in Volyn during first quarter of 2006 and 248 importing firms respectively. Both the exports and imports of the region were concentrated to the regional centre, Lutsk.

According to local government authorities of Volyn the priority fields for the attraction the foreign direct investments are:

- modernisation of the agro-industrial sector;
- machine building, wood-working, light and chemical industries;
- technological improvement of local enterprises;
- environmental protection; and
- tourism and recreational complex.

A special economic zone was established in 2000 to attract additional FDI into the region.

#### **4. Cross-border co-operation between the Brest region, the Lubelskie Voivodship and the Volyn region**

##### **4.1. An overview of the Bug Euroregion**

Since 1995 the core institution managing and organising international co-operation projects between Belarus, Ukraine and Poland has been the Bug Euroregion. The co-operation has become tighter after the EU enlargement in 2004. The Euroregion Bug covers an area of 64,000 sq. kms and is one of the largest European Euroregions. 31% of the area is on the territory of Poland, 28% in Ukraine and 41% in Belarus. Nearly 5 million people inhabit the Euroregion BUG. 47% of its population live in Poland, 31% in Belarus and 22% in Ukraine (Euroregion Bug, 2007). The map of the regions is shown on Figure 1.

The largest towns of the Bug Euroregion are regional capitals – Brest, Lublin and Lutsk (Luck). These towns are also academic centres of the region. Agricultural area constitutes more than 50% of the region. There are four national parks in the region. The region is an important transport corridor for trade between the EU countries and Eastern Europe. The administration of the Bug Euroregion is in local governments since 1998. The goals of Bug in the field of cross-border co-operation are (Euroregion Bug, 2007):

- spatial planning;
- communication and transport;
- education, health care, culture, sports and tourism;
- protection and improvement of the condition of natural environment;
- elimination of hazards and the effects of natural disasters; and
- developing relations among the inhabitants of cross-border areas, co-operation among institutions and businesses.



**Figure 1. The map of the Brest region, the Lubelskie Voivodship and the Volyn region**



The development of international collaboration is facilitated by various types of national organisations. In 2005, a national organisation 'Derzzowniszinform' was established, of which the major function has been to inform foreign institutions on companies interested in economic partnership (Youth of innovation, 2006).

The cross-border co-operation between the neighbouring regions of Belarus, Poland and Ukraine and is substantially financed by the EU programme INTERREG IIIA/TACIS CBC (EU Neighbourhood Policy since 2007). The project aims to develop border regions of EU and its neighbours. In 2005, an extensive project on international co-operation for small and medium-sized companies was realised. And the development of border infrastructure has recently been particularly attended to. The Jagodzin, Morowiczy-Kryzypow and Adamczuki-Zabrzeze border crossings were modernised in 2005. A Polish and Ukrainian transnational agency was established as well. The bordering areas of Volyn and Lublin regions are major participants of the Poland-Ukraine-Belarus neighbouring project. Within the project its actively operating component is the European Centre for Integration and Government Co-operation 'House of Europe' in Lublin, which promotes government co-operation in the neighbouring regions. A Volyn social organisation 'Our Cause' established the Centre for European Integration in Lutsk (Youth of innovation, 2006). The priorities of the EU Neighbourhood policy are:

**Priority 1: Increase of competitiveness of border regions through modernisation and development of cross-border infrastructure**

- Action 1.1: Modernisation and development of the existing transport systems aiming at improvement of accessibility of the region;
- Action 1.2: Development of mutual cross-border natural environment protection system; and
- Action 1.3: Development of business related and touristy infrastructure.

**Priority 2: Development of human resources capital and institutional forms of cross-border co-operation as well as improvement of safety of the borders of the European Union**

- Action 2.1: Strengthening of institutional cross-border co-operation and improvement of the quality of the human resources capital; and
- Action 2.2: Support of initiatives of local communities (Microprojects Fund administered by the Euroregion BUG).

## **5. Main problems, opportunities and solutions of the growth triangle**

The following section discusses main problems and possible solutions to develop cross-border co-operation in the Bug Euroregion. Author finds that there are many factors that are contributing to cross-border co-operation in the Bug Euroregion. Some of the main positive factors contributing to cross-border co-operation between Belarus, Ukraine and Poland are discussed below.

- *Favourable geographic location of the region, especially for the Brest region:* The cross-border region is located on the border of the EU, between Eastern and Western Europe. It has good opportunities to become a significant transit and tourism area. Figure 1 gives the map of the region. The City of Brest is located at Belarus-Poland border and it makes it easier for the Brest region to develop cross-border economic relations as the regional capital has the agglomeration that is often missing in border regions. An important transit corridor Berlin-Warsaw-Minsk-Moscow is running through the region.
- *Cultural proximity and historical relations:* The proximity of business culture and language within the region is contributing to regional cross-border integration.
- *Unique wildlife and low pollution, good possibilities for tourism development:* The region has beautiful, comparatively clean and “untouched” wildlife that is an important factor of tourism development.

- *Increasing financial and institutional support from the EU side:* Several funds and institutions are increasingly providing financial support and knowledge for developing cross-border regions. The Bug Euroregion is fully eligible for getting financing from the EU Neighbourhood Programme.
- *Increasing trade and investment relations between countries:* Trade and investment relations between Belarus, Ukraine and Poland are intensifying year on year. Table 5 gives an overview of foreign trade between observable three countries. Foreign trade has significantly increased in 2006 compared to same period in 2005. Foreign trade is quite balanced between countries and no clear net exporter or net importer can be distinguished.

**Table 5. Trade between Belarus, Ukraine and Poland in 2005 (USD million)**

EXPORTS				
IMPORTS	Country	Belarus	Ukraine	Poland
	Belarus		892 (22%)	722 (n.a.)
	Ukraine	940 (36%)		1407 (56%)
	Poland	979 (n.a.)	1011 (35%)	

Note: Growth of exports/imports from January-September 2005 to January-September 2006 is shown in parentheses.

Source: Statistical offices of Belarus, Ukraine and Poland, 2006; author's calculations.

- *Relatively successful of SEZs and FEZs:* The FEZ Brest established in 2000 and SEZ in Volyn are good tools for attracting foreign direct investments into regions and reducing unemployment. The technology transfer and spill-over effects coming from FDI are very beneficial for regional industrial development.

There are also several problems that may reduce the success of cross-border co-operation in the Brest-Volyn-Lubelskie regions as a tool for increasing economic development and competitiveness of border regions. Many of the problems discussed here are typical 'curse' of any border region.

- *A lack of human capital and inability to manage the EU projects, low absorptive capacity:* Weak institutional development in all three countries (especially Belarus and Ukraine) is a serious problem in cross-border co-operation. There is a lack of qualified staff limits the ability to apply and manage EU funded projects.
- *Political risk, especially political situation in Belarus is making possible investors cautious about future development and stability of reforms and sets several hindrances*

*for the EU-Belarus economic relations:* If the general investment climate is unfavourable, it is very difficult for border regions to compete with capitals to attract foreign direct investments.

- *Low development level of the Lubelskie region as the main co-operation partner on the EU side:* The Lubelskie region is one of the least developed regions in Poland and therefore its ability to raise funds from different EU projects is somewhat limited compared with other regions.
- *High corruption in all three countries:* Poland was at 61<sup>st</sup>, Ukraine at 99<sup>th</sup> and Belarus at 151<sup>st</sup> place in corruption perception index among 163 countries estimated in 2006 by Transparency International. High corruption and weak institutional development of countries makes it difficult to effectively manage and create cross-border co-operation programmes and reduces the overall attractiveness of a country for cross-border economic relations.
- *Low development level of infrastructure:* This is the most discussed problem of border regions. A lack of motorways, bad shape of existing roads, low development and capability border checking points are significant hindrances for cross-border economic relations.
- *Low standard of recreational and tourism attractions:* People to people co-operation and good tourism opportunities are very important preconditions for broader co-operation. Currently, tourism attractions are underdeveloped and depreciated and need lots of investments in the near future.

Some possible solutions to enhance the development of cross-border relations are suggested below.

- *To increase central state support while keeping existing regional management of the Bug Euroregion:* One field where the state support would be important is the tourism development and reconstruction of monuments therefore creating better investment climate also for private tourism firms. Tourism-related infrastructure is very important to develop by local authorities. The author finds that it is crucial to retain the local management of cross-border co-operation projects, but it is likely that local governments' budgets do not allow for substantial support for tourism development and central aid is required.
- *The author suggests reconsidering possibilities to attract foreign investments into agricultural sector of the region:* The Bug Euroregion is rich of high quality agricultural land enabling to produce raw materials for food industry. The problem is that the production technology in agricultural sector is rather outdated and FDI would help to introduce modern and competitive technologies in agriculture and food industry. Cheap local labour force and cheap raw materials with high technological level of foreign food processing firms could create competitive edge for border regions. Reduction of unemployment would be another positive effect of employment obligations.

- *Common cross-border projects for developing roads and border infrastructure:* A significant work in that field has already been done as this is the field, where substantial financing comes from the EU Neighbourhood Programme. Many border checkpoints have been renovated during last years. Author finds that is essential to systematically renovate all main border check-points, because the condition of border infrastructure is one of the key elements in developing cross-border economic relations.
- *Closer co-operation between academic institutions and regional authorities:* All three regions have stressed the academic infrastructure and network between regions. At the same time there is a lack of personnel managing the EU financed projects. The author suggests that the local governmental units should more co-operate with academic institutions and to integrate them into common cross-border projects. Close co-operation with academic institutions is also important to improve the technological level of firms in the region and increases the absorptive capacity and ability to learn from foreign enterprises.
- *Visa-free travel or instant short-term visas within the Bug Euroregion:* Visa-free travel for short-term business visits for the institutions and firms operating in the Bug Euroregion would promote co-operation between the firms within the growth triangle. Alternatively, instant short-term visas that are possible to arrange at the border crossings would also ease the cross-border co-operation in the Bug Euroregion.
- *Reconsidering services and benefits of FEZs/SEZs, to make them even more attractive:* Although FEZs/SEZs are offering several benefits for foreign firms they may not be enough to encourage international firms to produce there because of high international co-operation for attracting FDI. The author suggests considering to reduce income and profit taxes to zero per cent for some period and to replace them with investment obligations and employment of local labour. There is a strong trend in Europe towards reducing corporate income taxes and it could be worthwhile to consider following these trends at least in FEZs/SEZs to be competitive. The establishment of a joint technology park would be one possible solution to attract FDI into border regions.
- *Environmental collaboration between the regions:* Pollution does not stop at any state border and the cross-border co-operation in that field is required to maintain purity of nature in the region.

## 6. Conclusions

The border regions in the Brest region, the Volyn region and the Lubelskie Voivodship are similar in many aspects of development. The unemployment is higher than country averages, wages are lower and infrastructure is underdeveloped. All three regions are mainly agricultural, but some manufacturing sectors, e.g. machine building, chemical

industry, cotton fabrics and knitwork are also well developed. The Brest region is in comparatively better position, because the regional centre, the City of Brest, is located at Belarus-Poland border, and therefore contributes to development of the border area. The general economic development in the Belarusian regions is also more homogenous than in Poland and Ukraine.

In 1995, the Euroregion Bug was formulated to enhance cross-border co-operation between Lubelskie region and Volyn region, some years later the Brest region was added to the cross-border triangle. Several initiatives, meeting and joint projects have been organised by the Bug. Nevertheless, there have been concerns that the effectiveness of the Bug is still moderate.

There are many positive factors and opportunities that contribute to cross-border co-operation within the Bug region. The region is rich of clean and untouched wildlife and cultural heritage that enables for cross-border tourism development. At the same time, the Bug region is a key transport corridor between Eastern and Western Europe for inner land trade.

The author suggests that the development of infrastructure for trade and tourism should be in top priorities of the border regions. The current shape of roads and border crossings is quite below modern standards. Academic institutions should be more integrated into regional planning to increase the absorptive capacity and better manage financial aid from the EU Neighbourhood Programme. Environmental collaboration is also a very important field for future cross-border co-operation. Author also suggests considering visa-free travel between countries in case of short visits. In general, the author finds that the growth triangle between Belarus, Ukraine and Poland has a lot of unused potential for future development.

## References

- Baldwin R. E., Forslid, R. The core-periphery model and endogenous growth: stabilizing and de-stabilising integration. – NBER Working Paper No 6899, 1999, 21 pp.
- Brest Regional Executive Committee [<http://brest-region.by/en/economic/index.php?tid=2>] 15.01.2007.
- Brodzicki, T. Economic Transition and Economic Integration. Regional Effects for Poland, 2002, 18 p. [<http://ideas.repec.org/p/wpa/wuwpit/0310007.html>] 20.01.2007.
- Central Statistical Office of Poland [<http://www.stat.gov.pl/english/index.htm>] 15.01.2007.
- Erkut, G., Özgen, C. The economic and spatial peripherality of border regions in South-Eastern Europe, The 43rd European Congress of the Regional Science Association, Jyväskylä, Finland, 27th-30th August, 2003, 28 p.
- Euroregion BUG [<http://www.euroregionbug.lubelskie.pl/>] 25.01.2007.
- Free Economic Zone „Brest” [<http://tpp.brestobl.com/predpr/sezen.html>] 10.01.2007.
- Henk van Houtum, The INTERFACE model of cross-border economic relationships, Paper presented at 38th Congress of the European Regional Science Association, Vienna, Austria, August 28-September 1, 1998, 28 pp.
- Investment Attractiveness of the Volyn Oblast [<http://www.invest.voladm.gov.ua>] 20.11.2006.
- Kivikari, U. A Growth triangle as an application of the Northern dimension policy in the Baltic Sea region. – Policy paper of a Russian-European Centre for Economic Policy, 2001, 27 p.
- Krugman, P. Increasing Returns and Economic Geography. – *Journal of Political Economy*, Vol. 99, No. 3, 1991, pp. 483-499.
- Krätke, S. Regional integration or fragmentation? The German-Polish border region in a new Europe. – *Regional Studies*, vol 33/7, 1998, pp. 631-641.
- Lubelskie (Poland) and Volyn (Ukraine), Youth of innovation, 2006, [[http://www.schule.at/dl/region\\_PL.pdf](http://www.schule.at/dl/region_PL.pdf)] 12.12.2006.
- Niebuhr, A. The Impact of EU Enlargement on European Border Regions, HWWA Discussion Paper, No 330, 2005, 28 pp.
- Petrakos, G., Economou, D. The spatial aspects of development in south-eastern Europe, [<http://www.ersa.org/ersaconfs/ersa02/cd-rom/papers/139.pdf>] 10.01.2007.
- Pitoska, E. Euro-Balkan Co-operation: Reasonable Doubts Regarding the Developing Contribution of European Initiatives in the Weaker Borderland Regions, Paper presented at 46th Congress of the European Regional Science Association, Volos, 28-26 August, 2006, 14 p.
- Portrait of the regions [[http://forum.europa.eu.int/irc/dsis/regportraitsinfo/data/en/pl03\\_geo.htm](http://forum.europa.eu.int/irc/dsis/regportraitsinfo/data/en/pl03_geo.htm)] 29.01.2007.
- Statistical Office of Volyn Oblast [<http://www.vous.privat-online.net/>] 10.01.2007.
- State Statistical Committee of Ukraine [<http://www.ukrstat.gov.ua/>] 20.01.2007.
- The Economist Intelligence Unit. Country Report, Belarus, December 2006, 29 p.
- The Ministry of Statistics and Analysis of the Republic of Belarus [<http://www.belstat.gov.by/homep/en/main.html>] 15.01.2007.
- Topaloglou, L., Petrakos, G. The new economic geography of the Northern Greek border regions, Paper presented at 46th Congress of the European Regional Science Association, Volos, 28-26 August, 2006, 30 p.

## **Free economic zones in Belarus: Operations and results**

Peter Zashev

### **Contents**

1.	Introduction	183
2.	Free economic zones in Belarus	184
2.1.	Background	184
2.2.	An overview of the zone's operations	187
3.	Assessing the results	190
3.1.	Quantitative and qualitative benchmarks	190
3.2.	The Russian factor	192
3.3.	Summarising the findings	194
4.	Conclusions	195
	Sources	198



## **1. Introduction**

This article focuses on the special economic zones in Belarus. A free economic zone (FEZ) is a geographical region that has economic laws that are more liberal than a country's typical economic laws. Usually, there are two main goals pursued by the host country authorities for organising a FEZ. The first one is to increase the amount of incoming foreign investments. The second is to offer the environment in which foreign investors may create spill-over effects. Such spill-over effects could be in different areas, such as technology transfers and modernisation, improvement in labour skills, improvement in the activities of suppliers and subcontractors, development of new industrial clusters, etc.

This article has two research objectives: 1) to what extent the Belarusian Government has managed to attract foreign investments and what part the FEZs have played in this process; and 2) to evaluate the impact the FEZ operations on the Belarus economy and business environment. In the process of elaborating these two questions, a third question emerges that could be equally relevant and interesting for both academics and decision-makers, i.e. to what extent the attractiveness of the Belarus FEZs is grounded on the same special position that Belarus manages to keep as an external internality of Russia.

Answering to these questions is a challenging task. The first problem is the apparent lack of information. Most of the official Belarus sources seem somewhat overly optimistic. As this optimism is present in every possible aspect of the governmental reporting a researcher becomes sceptical over the reliability of the information. The problem is further exacerbated by the fact that any company operating in a Belarus FEZ will not really be able and willing to express opinions – such is the specifics of the Belarus political situation that any business is directly or indirectly fully dependent on the government.

Due to aforementioned problems, this article operates exclusively with secondary sources and tries to find innovative ways in finding indirect pro- and con-arguments. The paper is divided into three main parts. The first section deals with the actual establishment of the free economic zones in Belarus. The section goes through their major characteristics and reviews the menu of incentives they offer to investors. The second part represents a short

description of each of the six existing free economic zones and the third section analyses the results that these FEZs demonstrate eight years after their establishment and elaborates on the perceived impact they had on the Belarus economy. Finally, the article summarises the collected evidence and outlines the future possibilities that the FEZs contain.

## 2. Free economic zones in Belarus

### 2.1. Background

The first FEZ in Belarus were created in December 1998 with a Decree of the President of Belarus. According to Article 1 of this law, the FEZ is a part of the territory of the republic with precisely determined borders and under a special legal regime establishing conditions for carrying out entrepreneurial and other business activity. At present, six FEZs exist in Belarus as shown in Map 1.

**Map 1. Free Economic Zones in Belarus – location and foundation date**



The Belarus authorities describe the main objective of the FEZs as:

- 1) Attracting and using effectively foreign and national investments;
- 2) Creation and development of export-oriented enterprises;
- 3) Transfer of modern technology; and
- 4) Effective use of existing industrial premises and infrastructure.

The legislative framework envisages applying special regime to certain types of economic activity, such as:

- Sale of goods of own manufacturing produced by residents of the FEZs to foreign counteragents;
- Sale of the goods of own manufacturing produced by the residents of the FEZs in Belarus, provided that the goods are included in the list of import-substituting goods that adopted by the Belarusian Government and approved by the President; and
- Sale of the goods of own manufacturing produced by the residents of the FEZs to the other FEZ residents (Vlasova & Partners, 2006).

Despite the fact that banks are excluded from the special regime applied in the FEZs, there are several banks in operation, such as SomBelBank (Russia, Latvia), Atom-Bank<sup>1</sup> (Latvia, Belarus), Northern Investment Bank (USA, UK), International Reserve Bank (UK), and Lorobank (USA, Latvia).

Companies interested to settle in the free economic zones start with the preparation of an investment proposal. The main requirements to the potential investor are (Ibid.):

- The amount of the statutory fund for legal entities should be not less than USD 20,000; and
- At least 90% of the imported equipment has to be newer than 5 years.

These requirements are well indicative of the fact that the Belarusian Government is not very demanding when it comes to the size and the technological novelty of the potential investment.

*Taxation:* The FEZs offer privileged tax regime for the residents of the FEZs. Besides, FEZ residents also enjoy all general tax preferences and exemptions established by the laws of Belarus for all other business entities. A summary of the tax relieves offered by the Belarusian free economic zones is given in Table 1.

**Table 1. Tax allowances and relieves for FEZ residents**

<b>Profit tax</b>	<p>For Mogilev FEZ and Grodnoinvest FEZ - 50% of the rate established by the legislation of Belarus</p> <p>For Brest, Minsk, Gomel-Raton, Vitebsk FEZs - about 60% of the rate established by the legislation of Belarus</p> <p>A tax is not imposed on the profit directed at investments in Belarus</p> <p>Profit tax from the sales of own production is not levied for 5</p>
-------------------	--

<sup>1</sup> Its license is suspended as of February 2007.

	years after the declaration of the profit
<b>Value added tax</b>	For Brest, Minsk, Gomel-Raton, Vitebsk FEZs - 50% of the rate established by the legislation of Belarus
<b>Tax on income from securities</b>	For Vitebsk, Mogilev, Grodnoinvest FEZs - 50% of the rate established by the legislation of Belarus
<b>Single tax</b>	For Mogilev and Grodnoinvest FEZs - 65% of the rate established by the legislation of Belarus
<b>Republican single tax</b>	Not levied
<b>Real estate tax</b>	Not levied
<b>Extraordinary tax and compulsory deductions to state employment promotion fund</b>	20% of the rate established by the legislation of Belarus
<b>Customs duties and taxes</b>	<p>These are not levied and the measures of the economic policy are not applied:</p> <ul style="list-style-type: none"> <li>• when foreign and domestic goods are imported on the territory of a free customs area;</li> <li>• when the goods produced on the FEZ territory are exported outside Belarus;</li> <li>• when the goods that are produced on the FEZ territory and regarded as import-substituting products according to the list approved by the Government of Belarus, are imported from the FEZ territory to the other customs territory of Belarus</li> </ul>

Source: Export.by.

*Customs regulation:* According to the Belarus authorities FEZs may be regarded as being but under the customs regime of the Free Customs Zone (FCZ). During the imports of the goods to the territory of a FCZ, as well as during the exports of the goods coming from the territory of a FEZ, from its territory beyond the boundaries of Belarus taxes, customs duties, excluding the customs registration fees, are not collected and the measures of economic policy are not applied (Ibid.).

In September 2005, the authorities issued a new 'Instruction on the Customs Regime of the Free Customs Zone'. According to it customs processing is not required:

- In case of imports of the goods traded under the regime of free turnover from the rest of the customs territory of Belarus, as well as in case of imports of the goods that are not subject to customs processing from the Russian Federation; and
- In case of exports of the above mentioned goods, as well as goods fully-produced from them to the rest of the customs territory of Belarus or to the Russian Federation (Ibid.).

*Currency regulation:* Another prominent specific of the Belarusian FEZs is that their residents are allowed to use foreign currency, securities in foreign currency, and/or payment documents in foreign currency between the residents.

*State guarantees to the residents of the FEZ:* The Belarusian authorities guarantee that no forced nationalisation, requisition or similar measures would be allowed on the territory of the FEZ, except for suspension of the exports of the invested property from the territory of a FEZ until the elimination of the possible indebtedness by the investor. All guarantees established by the current legislation of Belarus, including the Investments Code of the Republic of Belarus are valid on the territory of the FEZ.

The Belarusian State guarantees to the foreign investors the right to get back their share in the property of the enterprise at its remainder value, as well as the transfer of their due sums of the incomes, including the ones in foreign currency, received from investments in the zone, beyond the boundaries of the FEZ and Belarus. Interestingly enough this matter is decided in different ways when it comes to native investors (Ibid.).

## **2.2. An overview of the zone's operations**

According to the Belarus Ministry of Statistics, the free economic zones residents, excluding the banks registered in the zones, accounted for investments worth USD 231 million as of June 2006. The leaders are the FEZ in Brest and Minsk with USD 83 million and USD 72 million, followed by Gomel-Raton with USD 35 million, Vitebsk with USD 21 million, Mogilev with USD 12 million, and finally Grodnoinvest with USD 10 million. Altogether 278 companies were registered in the FEZs, and out of these 258 were in operation (PBUSSR, 2006).

*FEZ Brest:* If we quote the FEZ Brest's official web site, 95 companies operate in the zone, including 75 with foreign capital. The zone residents have declared USD 120 million<sup>2</sup> worth of investment (FEZ Brest, 2006). If we quote the official site of the Brest regional executive committee (i.e. the regional government), 90 companies operate in this zone, including 68 with foreign capital. According to this source the zone companies have declared USD 330 million worth of investment (BREC, 2006). According to both aforementioned sources, the capital comes from 19 countries, including Germany, Cyprus, Great Britain, the Czech Republic, Russia, Poland, the USA, the Bahamas, France, Gibraltar, Israel, Italy, Latvia, Moldova, and Norway.

The companies operating in the zone are engaged in wood processing, production of furniture, MDF surfacing materials, confectionery, meats and sausages, fish and sea food, fluorescent luminaries, paints and lacquers, equipment to paint on the road marking elements, refrigerating equipment, electrical engineering, heat-resistant sheet glass, plastics, thermo-shrinking polyethylene film and other products (FEZ Brest, 2006).

*FEZ Minsk:* As of July 2006, there were 75 enterprises residents in operation of which 54 were with foreign capital. The companies located in the FEZ Minsk employ altogether 6000 people. The three leading investors are from the UK 49%, the USA 12% and Latvia 10%. 65% of the production done in the FEZ Minsk is in the field of mechanical engineering and metalworking, followed by chemical and petrochemical industry with 12% (Invest.Belarus.by, 2006).

The FEZ Minsk has attracted USD 308 million, including USD 85 million of foreign investments. In the first 6 months of 2006, more than USD 30 million were attracted, of which USD14 million were foreign investments (Ibid.). By the end of 2006, more than USD 55 million of investments were received, of which USD 20 million were of foreign origin (FEZ Minsk, 2007).

*FEZ Gomel-Raton:* As of October 2006, there were 35 residents, including 20 companies with foreign investments in the zone (FEZ Gomel-Raton, 2006). For the first nine months

---

<sup>2</sup> In the absence of any single large investment between the two dates, it is unclear how the figure grows from USD 83 million on July 1st 2006 to USD 120 million three months later on October 1<sup>st</sup> 2006.

of 2006, the foreign trade turnover of the residents of the zone made up USD 112 million, or 28% compared to the same period of 2005. The exports totalled USD 56 million. In the period under review, the FEZ Gomel-Raton attracted investments to the tune of USD 11 million as against USD 2 million within the same period of 2005 (Ibid.). The FEZ accounted for only 5% of the total foreign investment attracted by the Gomel region (GREC, 2006). The leading foreign investors are Belcaps, Multipack, Kashtan and Intertape – all of them belonging to the same Alcopack Group from Germany.

*FEZ Vitebsk:* As of 2006, there were 27 enterprises registered in the FEZ. The accumulated investments were very modest standing at USD 45 million. In terms of countries of origin, the leading investors are the USA with 21%, Russia with 19%, the UK with 18%, and Germany with 16%. Quite interestingly, 61% of the entire production output of the FEZ Vitebsk belongs to companies operating in 'oil industry' (FEZ Vitebsk, 2006).

More than 50% of these investments come from 3 companies: Vitella being a part of the German Vicos Narungsmittel GmbH invested USD 8 million in the production of chocolate icing for confectionery. Number of employees: 62. The Russian Soyuz-Cable invested USD 9 million in the production of optical cable. Number of employees: 86. FORTEx Water Technologies JV Incorporated in 2004 (the Czech Republic, Belarus). The US Chess-Bel started its 'production of advanced motor gasoline' in the FEZ Vitebsk in 2000 and invested USD 8 million. Even if these three companies represent more than 50% of the cumulative FDI attracted by the FEZ Vitebsk, they employ altogether only 223 employees (InvestBelarus, 2006).

*FEZ Grodnoinvest and FEZ Mogilev:* Geographically, the FEZ is situated in the northwest of the country in immediate proximity to the border with Poland and Lithuania. The nearest checkpoint on the EU border is at a distance of 15 kilometres from the city. At the beginning of 2006, there were 29 enterprises registered in the FEZ with total investments exceeding USD 24 million (InvestBelarus, 2006). Throughout the year 2006, the total number of enterprises grew to 39 with capital from 16 different countries. 38% of the investments come from Poland followed by Germany 17% and the USA with 16%. In terms of their industrial profile, 40% of the production output is classified as construction materials followed by woodworking with 32% (FEZ Grodnoinvest, 2006). The major portion

of the output (over 70%) is exported primarily to Russia. For a very short period the residents created about 1500 new jobs, which is 40% unemployment in Grodno (InvestBelarus, 2006).

The FEZ Mogilev, being one of the youngest FEZs in Belarus, was established in 2002. Four years later in 2006, the FEZ had registered altogether ten companies whose founders come from 7 countries: Belarus, Russia, Austria, Germany, Denmark, Latvia and Turkey. According to the data for January-December 2006, their exports accounted for USD 24 million, of which USD 20 were in fact exports to Russia (FEZ Mogilev, 2006). The largest investors were the Belarus-Russian Joint Venture Mogilevsky Vagonostroitelny Zavod (Carriage-Building Works). The company has invested USD 7 million, since it was founded in 2005. It is followed by the Belarus-Germany Joint Venture Jockey Plastic Mogilev created in 2003 with investments of USD 5 million for the production of plastic containers. The third largest company was the Belarus TechnoTex that started production of industrial textiles in 2002 and invested some USD 3 million (InvestBelarus, 2006).

### **3. Assessing the results**

#### **3.1. Quantitative and qualitative benchmarks**

According to the Belarus Ministry of Statistics, there were registered altogether 278 companies in the 6 existing FEZs, of which in active operation were 258. The number of companies with foreign capital was approximately 210. As of January 2006, there were 3545 enterprises with foreign capital (1903 joint ventures and 1642 foreign enterprises) registered in whole Belarus (MFA, 2006). Thus, we may be concluded that the share of FEZ companies in the total amount of foreign companies operating in Belarus in 2006 was approximately 6%.

As of July 2006, the cumulative FDI attracted by the 6 FEZs were USD 231 million, excluding the banks in the free economic zones. The leaders were the FEZ Brest with USD 83 million and the FEZ Minsk with USD 72 million, followed by the FEZ Gomel-Raton and the FEZ Vitebsk with respectively USD 35 million and USD 21 million. The FEZ



Mogilev and the FEZ Grodnoinvest accumulated USD 12 million and USD 10 million respectively. Is USD 231 million a lot?

For the period 2001-2006, Belarus accumulated approximately USD 1.4 billion of FDI. That means that for all their existence<sup>3</sup>, tax benefits and favourable conditions the Belarus FEZs accounted for approximately 17% of the total FDI between 2001 and 2006.

The figures do not look better if we review the share that the FEZs have in the total exports of Belarus. As of July 2006, the Belarusian exports reached USD 9.3 billion with the exports to Russia being USD 3.1 billion and exports to non-CIS countries at USD 5.5 billion (IMF, 2006)<sup>4</sup>. During the same period, the FEZ residents exported USD 336 million, including USD 277 million to the CIS countries, out of the aforementioned amount USD 246 million went to Russia alone (News.by, 2006). That means that the Belarusian FEZs account for less than 4% of the total Belarusian exports, and for some 8% of Belarusian exports to Russia.

The success of the Belarusian FEZs does not look more convincing if they are measured qualitatively. The zones did not manage to attract any large multinational company, which is also quite indicative for the general investment climate of Belarus. One of the largest names in the Belarusian FEZs is perhaps Alcopack Group from Germany. Most of the investors from Western Europe in the Belarusian FEZs are small or medium-sized companies. Some of them have unclear origin, such as the producer of hydrocarbon-liquefied gas for automobiles and communal household usage who is presumably from the UK. Others are outright schemers, such as the Swiss company UPEKO-Industries registered in the FEZ Gomel-Raton. It appears that the whole company was owned by a Ukrainian citizen who managed through several schemes to obtain credits without much of an activity. For that he was jailed for 6 years by the Belarusian court in 2006 (KGB, 2006). In that story it is interesting to note that despite the scheme FEZ Gomel-Roton still claims to have a resident of Swiss origin. Furthermore, the investigation discovered that machinery for USD 50,000 was presented as worth USD 750,000 in the founding capital of the FEZ resident (Ibid.). That example shows that all indicators of investments attracted

---

<sup>3</sup> The two largest were created already at the end of 1998.

<sup>4</sup> The IMF also uses and quotes the Belarusian authorities and mass media.

and countries of origin of the companies operating in the FEZs should be treated with a dose of scepticism.

In addition, many companies that presumably are Western could very probably be Russian-owned. One example is The International Reserve Bank in the FEZ Minsk, whose shareholders “... *are legal entities of the British Commonwealth countries*” (IRB, 2007), but according to the FEZ Minsk website, it is Swiss-Belarusian Joint Venture. Another example could be Gashimeksport, a company of the UK origin, which registered in the FEZ Vitebsk. Its investors are of Cypriot origin.

As the significant amount of FEZ residents comes from Belarus itself, Russia or other CIS countries, their capability for technology transfers and the possible technology spill-over effects is highly questionable. This can be proved by the structure of their production and exports. Among the main exports within the first half of 2006 were furniture and furniture components (13%), fish and canned fish products (10%), canned meat and sausages (9%), plastic and plastic products (8%), aluminium profiles and constructions (7%), metal caps and packaging accessories (4%), refrigerating equipment (3%) (News.by, 2006). The aforementioned items are not really technologically-advanced products.

There is however a significant positive spill-over when it comes to productivity and labour efficiency. By 2004, the six FEZs were employing some 20,000 people or 0.5% of the entire Belarusian labour force. Their exports per employee are some 6 times higher than the average and their labour productivity 1.4 times higher. Unfortunately, their spill-over effect is limited to inside the FEZs, and even in the FEZs some 28% of the residents are generating losses (Soyuz.by, 2006).

### **3.2. The Russian factor**

In the first half of 2006, the Russian market accounted for 73% of the Belarusian FEZs' exports, or USD 246 million. Within the same period the Belarusian FEZs imported USD 341 million worth of goods. Predominantly, these were goods originating from non-CIS countries. Therefore, it could be correct to conclude that by large the FEZs' main activities

are to import goods from the non-CIS countries, to process them and later to export them to the CIS countries in general, and Russia in particular.

That may raise a general suspicion that a FEZ-registered company may import customs free goods from, say, Western Europe, and based on the customs union between Belarus and Russia later ship them to Russia. In short, the Belarusian FEZs have become 'star gates' to Russia, which allow foreign products to enter the Russian market without customs fee. That is exactly what the Russian State Customs Committee accused Belarus of doing in 2005. During the first nine months of 2005, Belarus exported to Russia 350,500 TV sets and approximately 265,000 tonnes of sugar (Soyuz.by, 2005).

The Belarus authorities defended themselves that according to the customs union for a product to be recognised as a Belarusian it should be assembled by at least 50% of Belarus manufactured components. When initiating exports to Russia and other CIS countries, every Belarusian exporter should obtain the so-called ST-1 (CT-1), a certificate that is issued by the Belarusian Chamber of Commerce and Industry, which certifies that the product's country of origin is Belarus. Still later the Belarus authorities had to admit that there were cases where FEZ residents import sugar from the EU, and export it to Russia as sugar syrup that is with the minimum processing (Autoline, 2004). As a result from January 2007, Belarus agreed to impose self-made quotas on sugar exports to Russia, limiting these exports to 180,000 tonnes in 2007 and 100,000 tonnes in 2008 (Lexim, 2007).

The sugar dispute is indicative of two facts. Firstly, the Russian side is aware of Belarus in general, and the Belarusian FEZ in particular, being possible star gates for foreign goods entering the Russian market customs free. The other important conclusion stems from the fierce defensive rhetoric of the Belarus officials. This means that they still hope to turn the Belarusian FEZs in huge manufacturing hubs in which products with 50% or less of foreign components are assembled and then shipped customs free to Russia and the other CIS countries. The very idea that the determination, if 50% of Belarusian components are used or not, is in the hands of only the Belarusian Chamber of Commerce and Industry, is a serious precondition for ongoing mistrust by the Russian customs. This mistrust may turn into an open hostility any time if Russian business interests are seriously threatened.

### **3.3. Summarising the findings**

Before presenting a short review of the results, it is worth coming back to the original intentions of the Belarus authorities. These were to effectively use foreign and domestic investments that will lead to the creation of the export-oriented enterprises. In this process, the investments will secure transfer of modern technology and effective use of existing industrial premises and infrastructure. Table 2 summarises the main findings of this article by dividing them in two areas: 1) FEZs' results against the objectives set up by the Belarus authorities, and 2) additional impacts of FEZ operations.

Regretfully, the summary does not indicate grounds for optimism in neither of the two areas. The objectives of the Belarus Government are not even closely met, and the general performance of the FEZs is by large disappointing. Trying to address this problem the government is trying to re-consider the strategy, and put more pressure on the FEZs authorities but their reaction could be characterised as typical bureaucratic survivalism expressed in overly optimistic reporting of growing investments, foreign companies and job places. To what extent the Belarus Government is aware of the real situation is a question mark.

**Table 2. A summary of the main findings**

<b>Official objectives</b>	<b>Results</b>
<b>1. Attract foreign investments</b>	<ul style="list-style-type: none"> <li>- 6% of the foreign companies operating in Belarus were registered in FEZs.</li> <li>- FEZs account for 17% of the comparatively very low FDI in Belarus between 2001 and 2006.</li> </ul>
<b>2. Creation and development of export-oriented enterprises</b>	<ul style="list-style-type: none"> <li>- FEZs account for less than 4% of the total Belarusian exports and for some 8% of the Belarusian exports to Russia.</li> <li>- FEZs imported USD 341 million worth of goods. In the same period, 73% of the FEZs exports or USD 246 million goes to Russia.</li> </ul>
<b>3. Transfer of modern technology and effective use of existing industrial premises and infrastructure</b>	<ul style="list-style-type: none"> <li>- The structure of production and exports will not indicate any significant technology transfers that may lead to higher value added products.</li> <li>- Notable absence of large multinational companies.</li> <li>- The FEZs have limited impact on boosting productivity on a national level, as they employ only 20,000 people, or 0.5% of the entire Belarusian labour force.</li> </ul>
<b>Additional impacts of FEZs operations</b>	
<b>4. Attracting national investment, instead of foreign investment</b>	<ul style="list-style-type: none"> <li>- The FEZs has attracted a good number of Belarusian companies as they search for more business friendly environment.</li> <li>- Belarusian FEZs attract also Russian companies whose only aim is to minimise their import duties for the Russian market.</li> </ul>
<b>5. Straining relations with Russia</b>	<ul style="list-style-type: none"> <li>- One of main functions of the FEZs is as low-tech assembly lines between Western countries and Russia, i.e. the main attraction is the possibility to minimise Russian customs duties. It will certainly have a negative impact on the Russia-Belarus economic relations. Especially, if there is a further political drift between the two countries.</li> </ul>
<b>6. Bureaucratic survivalism</b>	<ul style="list-style-type: none"> <li>- The reporting of the FEZ authorities is of dubious value. In reality, many FEZ-registered companies are Belarusian with a fictional Western partner. Many are pure schemes, such as the Swiss UPEKO-Industries. As the FEZ officials face growing criticism from the Belarus Government and the Belarusian President, they come with a skill well polished during Soviet times – good looking reports.</li> </ul>

#### **4. Conclusions**

The free economic zones in Belarus were created with the intention of attracting foreign investors, and hence, to cause spill-over in various ways, such as technology transfers, labour productivity and boost the country's competitiveness. Three of the FEZs were created almost 10 years ago and another three approximately 5 years ago. Judged by

their overall results one may reach the conclusion that they have been rather disappointing in their performance both in terms of foreign companies attracted and in terms of their economic performance. Furthermore, it is difficult to discover the presence of significant technology transfers.

A FDI comparison between Belarus and some other post-communist countries supports the above conclusion. Having almost 4 times larger population the FDI figure for Poland is almost 9 times higher. If we eliminate the EU as a possible explanation, Ukraine could be another comparison point – with a population that is approximately 4.5 times larger than that of Belarus, the FDI per capita for the 2000-2005 period are some 30% higher. Or Bulgaria that prior to EU membership managed to accumulate 5 times more FDI per capita with a population that is some 25% smaller than that of Belarus (see Table 3).

**Table 3. Foreign direct investment in selected countries of Central and Eastern Europe**

	FDI inflow, EUR million						Per capita	Per capita
	2001	2002	2003	2004	2005	forecast 2006	inflow, EUR 2005	stock, EUR 2005
Poland	6372	4371	4067	10279	6132	7000	161	1835
Slovakia	1768	4397	593	1016	1694	2000	314	2414
Estonia	603	307	822	838	2232	1000	1658	7717
Latvia	147	269	260	563	503	500	219	1759
Lithuania	499	772	160	623	807	1000	236	1600
Bulgaria	903	980	1851	2727	1789	2000	231	1105
Croatia	1503	1195	1788	989	1328	1500	299	2970
Belarus	107	262	152	132	245	200	25	206
Moldova	114	140	69	124	181	100	50	266
Russia	3069	3660	7041	12422	11731	12000	82	687
Ukraine	884	734	1260	1380	6263	2000	133	310

Source: The Vienna Institute for International Economic Studies, 2006.

Taken into account the official Belarusian statistics, which one may find to be overly optimistic, the total amount of investments accumulated by the FEZ represents some 17% of the very modest total Belarusian FDI stock for the period between 2001 and 2006. In terms of the number of companies attracted, the FEZs also prove disappointing accounting for 6% of the total number of foreign companies registered in Belarus. The figures are not

encouraging also when it comes to exports – one of the main tasks expected by the FEZ according to the Belarusian authorities. The direction of their sales is clear. Over 70% of the products go to Russia. However, the total figures also do not impress as the Belarusian FEZs account for less than 4% of the total Belarusian exports and for some 8% of Belarusian exports to Russia.

The disappointment of the Belarusian FEZs' performance was also expressed by the President of Belarus himself in 2005 when he commented the insignificant share of the FEZs with the words *"If that is the return on investment that we have from the FEZ the question that arises do we really need them?"* (Ermak, 2005).

The findings of this article fully comply with the comment of the Belarusian president. However, the prospects for a change resulting in a much more rapid development of the FEZ with the following tangible impact of their activity on the Belarusian economy are not really considerable. Significant inflows of foreign investments may come in Belarus and its FEZs from two directions: Russia and the EU. The current disputes between Russia and Belarus will certainly strain the economic connections possibly to the point of dismantling the customs union between the two countries. Thus, Russia is somewhat unlikely to dramatically increase its investments in Belarus even if geopolitically that would be a rather natural step. The EU, on the other hand, will never attempt more active economic cooperation and expansion to Belarus while Lukashenka is a president and democracy is not restored in full. Therefore, the desire of the Belarusian elite to maintain the political status quo does not allow realistically expecting increased investments from Russia and the EU. In these circumstances, the Belarusian authorities seem to bet on countries such as Venezuela and Iran. But will it work?

The future of the Belarusian FEZs will undoubtedly gravitate around the political situation in Belarus in general and particularly depend on the course of its future foreign policy, because even if the zones are free they still remain an integral part of Belarus with all its contemporary political and economic shortcomings.

## Sources

- Autoline:** В Беларуси вводится запрет на ввоз белого сахара в свободные таможенные зоны, 19.11.2004, Available HTTP < [http://autoline.com.ua/news\\_transport.php?code=041119161044](http://autoline.com.ua/news_transport.php?code=041119161044) > (accessed January 15<sup>th</sup>, 2007)
- BREC** /Brest Regional Executive Committee/: Information about the FEZ Brest, 25.09.2006, Available HTTP < <http://brest-region.by/en/economic/article.php?id=91> > (accessed January 15<sup>th</sup>, 2007)
- Ermak Dmitri:** СЭЗ - зоны особого внимания, 18.05.2004, Available HTTP < <http://www.valex.net/news/180504.html> > (accessed February 5<sup>th</sup>, 2007)
- Export.by:** Free Economic Zones, Available HTTP < <http://guide.export.by/eng/view.php?p=018> > (accessed February 8<sup>th</sup>, 2007)
- FEZ Brest:** Overview, Available HTTP < <http://www.fez.brest.by/review/review.html,en,2> > (accessed February 8<sup>th</sup>, 2007)
- FEZ Gomel-Raton:** Overview, Available HTTP < <http://www.gomelraton.com> > (accessed February 5<sup>th</sup>, 2007)
- FEZ Grodnoinvest:** About FEZ, Available HTTP < <http://www.grodnoinvest.com/eng/AboutFEZ> > (accessed February 5<sup>th</sup>, 2007)
- FEZ Minsk:** Information on FEZ Minsk activity, Available HTTP < <http://www.fezminsk.by/cgi-bin/fznews.pl?IN=0&R=b> > (accessed April 12<sup>th</sup>, 2007)
- FEZ Vitebsk:** Statistical Data, Available HTTP < <http://www.fez-vitebsk.com/en/?f=stat> > (accessed January 30<sup>st</sup>, 2007)
- GREC** /Gomel Regional Executive Committee/: In January-September, residents of FEZ Gomel-Raton increase production by 33,8%, 23.11.2006, Available HTTP < [http://www.gomel-region.by/en/bottom\\_menu/news/economics?ns\\_id=6296](http://www.gomel-region.by/en/bottom_menu/news/economics?ns_id=6296) > (accessed February 14<sup>th</sup>, 2007)
- IMF:** Belarus: Periodic Report (Issue #6), September, 2006, Available HTTP < <http://www.imf.org/external/country/BLR/rr/MIN/0906.pdf> > (accessed February 1<sup>st</sup>, 2007)
- IRB** /International Reserve Bank/: Historical background, 2007, Available HTTP < [http://www.irb.by/en/content/about/historical\\_background/?irbby=b99e99fc1fbe21fa1e0be5f6862f8ea9](http://www.irb.by/en/content/about/historical_background/?irbby=b99e99fc1fbe21fa1e0be5f6862f8ea9) > (accessed April 12<sup>th</sup>, 2007)
- InvestBelarus:** FEZ Vitebsk, Available HTTP < <http://www.invest.belarus.by/en/investment/fez/vitebsk/> > (accessed February 8<sup>th</sup>, 2007)
- InvestBelarus:** FEZ Grodnoinvest, Available HTTP < <http://www.invest.belarus.by/en/investment/fez/grodno/> > (accessed January 15<sup>th</sup>, 2007)
- InvestBelarus:** FEZ Mogilev, Available HTTP < <http://www.invest.belarus.by/en/investment/fez/mogilev/> > (accessed January 24<sup>th</sup>, 2007)
- KGB** /KGB of Republic of Belarus/: КГБ информирует / 02 октября 2006, 12.10.2006, Available HTTP < <http://www.kgb.by/press/inform/30.html> > (accessed April 12<sup>th</sup>, 2007)
- Lexim.ru:** Россия и Белоруссия согласовали условия поставок сахара, 18.01.2007, Available HTTP < <http://www.lexim.ru/news/6473/> > (accessed February 10<sup>th</sup>, 2007)
- MFA** /Ministry of Foreign Affairs of Belarus/: Activities of Foreign Companies and Joint Stock Ventures in Belarus, Available HTTP < <http://www.mfa.gov.by/eng/index.php?d=economic/investment&id=9> > (accessed February 6<sup>th</sup>, 2007)
- News.by:** Резиденты белорусских свободных экономических зон на подъеме, 28.08.2006, <http://www.news.by/511/2006-08-28/18403/12826> > (accessed February 8<sup>th</sup>, 2007)
- PBUSSR** /Post Back USSR/: Резиденты СЭЗ Беларуси в январе-июне увеличили объем производства на 44,7% до Br1,2 трлн, 22.08.2006, Available HTTP < [http://www.pbussr.ru/index.php?razdel=3&condition=show\\_news&page=12&id=15964](http://www.pbussr.ru/index.php?razdel=3&condition=show_news&page=12&id=15964) > (accessed February 3<sup>rd</sup>, 2007)



- Soyuz.by:** 2006: Правительство Беларуси установило критерии оценки эффективности деятельности резидентов свободных экономических зон на территории страны, 10.10.2006, Available HTTP < <http://www.soyuz.by/second.aspx?document=22725&uid=2&page=21&type=Qualifier> > (accessed February 15<sup>th</sup>, 2007)
- Soyuz.by:** ГТК Беларуси готов к диалогу, 15.11.2005, Available HTTP < <http://www.soyuz.by/second.aspx?document=11335&type=Qualifier&uid=464&page=41> > (accessed February 3<sup>rd</sup>, 2007)
- WIIW** /The Vienna Institute for International Economic Studies/: Database on Foreign Direct Investments in Central, East and South-eastern Europe, 2006 Available HTTP < [http://www.wiiw.ac.at/pdf/fdi\\_may06\\_presse\\_eng.pdf](http://www.wiiw.ac.at/pdf/fdi_may06_presse_eng.pdf) > (accessed January 28<sup>th</sup>, 2007)
- Vlasova & Partners Law Firm:** Free Economic Zones on the Territory of the Republic of Belarus, 2006, Available HTTP < <http://www.vap.by/en/publications/reviews/fez.html> > (accessed February 8<sup>th</sup>, 2007)

## Future options of Belarus

Kari Liuhto

***The future of Belarus is closely linked with the destiny of president Lukashenka and the politico-economic elite surrounding him.*** However, before describing the future options of Belarus, it is necessary to have a look on the economic foundation of the country and major change forces around the Lukashenka regime.

If one starts from the economic pillars of the country, it needs to be emphasised that Belarus is ***an overwhelmingly state run economy***<sup>1</sup>. Only 12-25% of the country's economic activity is formed by private entities (Centre for Eastern Studies, 2007a; EBRD, 2006)<sup>2</sup>.

Analysing the real competitiveness of the Belarusian industries is everything but easy as the state supports the state-owned companies and the business oligarchy loyal to the presidential administration in various ways, and simultaneously, restricts foreign competition by making imported goods more expensive with tariffs and non-tariff barriers and the operations of foreign firms less effective with unnecessary bureaucracy and state interference (EIU, 2007). The analysis of the true competitiveness in a country, which lacks both domestic and foreign competition, is a challenging exercise.

---

<sup>1</sup> The situation in the enterprise sector is that there is little private ownership of large enterprises, though a substantial number of smaller enterprises have been privatised (Lawson, 2003). It should not be forgotten that not a single key enterprise was privatised in 2005 (Centre for Eastern Studies, 2007a). Marples (2003, 32) states "*the average village resident or factory worker is as dependent on the state today as in the Soviet period.*"

<sup>2</sup> As a comparison, the private sector forms 65% of the Russian and the Ukrainian GDP (EBRD, 2006).

The aforementioned exercise is further complicated by the fact that Belarus is **an externally subsidised economy**, i.e. Russia significantly subsidises Belarus. There are several ways of subsidising.

For instance, **Russia sells natural gas below the market price**. Even if the natural gas price was lifted from USD 47 per 1000 cubic meters to USD 100 in the beginning of 2007, it needs to be remembered that the Baltic States pay for their gas USD 240. In other words, despite this increase in the natural gas Russia continues giving a gas subsidy to Belarus worth approximately USD 2.8 billion in 2007 alone, as Belarus imports some 20 billion cubic meters of gas from Russia.

**Russia also subsidises Belarus with oil**. Russian oil companies have had a favourable tax incentive to refine their oil in Belarus and sell oil products to the West. This Belarusian oil corridor will be closed, which will hurt the Belarus public finances further. The Russian Ministry of Finance estimates that the new rules governing trade in oil and petroleum products will generate USD 2.5-3.0 billion a year, i.e. the Belarusian budget is hurt by more or less the same amount (Centre for Eastern Studies, 2007c).

In addition, Russia will stop the unofficial subsidising of the Lukashenka regime by closing **the shadow import channel from the West via Belarus to Russia**. So far, Belarus has been used as the shadow import channel to Russia, i.e. the Russian import taxes have been avoided by using the customs union between Belarus and Russia. It is impossible to evaluate the overall value of these backdoor imports but it is self-evident that the closure of the Belarusian gateway to Russia diminishes Lukashenka's popularity among the Belarusian oligarchy.

It is certain that **the Lukashenka regime is incapable of fully compensating the increasing energy price to the Belarusian industries and the Belarusian households**<sup>3</sup>. It has been argued that the Lukashenka regime may aim at compensating the energy bill increase by raising taxation of the natural gas and oil transit via Belarus to the West, i.e. the Lukashenka regime may aim at putting the Russian firms to pay for the

---

<sup>3</sup> Nearly 60% of the Belarusians believe that increasing energy prices will deteriorate either slightly or considerably their living standard (IISEPS, for reference see Virta, 2007).

increased energy bill. Despite this idea, the method allows the Belarusian Government to compensate only a fraction of the increased energy bill (AFP, 2007).

It has also been argued that the Lukashenka regime may aim at financing the increased bill with **foreign lending**. The Belarusian Ministry of Economy has revealed plans to take out a USD 1.2 billion loan from China. The Belarusian authorities also approached the Russian Government in February 2007 regarding a USD 1.5 billion loan. In addition, Belarus may aim at find financing from commercial capital markets, which are likely to be very reluctant to finance a shaking regime in favourable terms (EIU, 2007).

In addition to foreign loans, the Belarusian state may start to **sell its assets to finance emerging budget deficit**. At the end of February 2007, the Belarusian Ministry of Economy was working on a plan to sell minority stakes in the largest state-owned enterprises, including the Naftan and Mozyr refineries<sup>4</sup>, the Polimir petrochemical plant, Belshyna, Grodno-Azot, the MAZ automotive plant, the telecom monopoly Beltelecom, the Nemen tobacco plant, the Krynitsa Brewery, and the Minsk Wine Factory (Centre for Eastern Studies, 2007b).

As the Belarusian State will be able to compensate only partially the increasing energy bill, **the Belarusian industries are forced to improve their energy efficiency or increase their prices**, which will lead to diminishing exports of their products. The energy saving programmes are insufficient to fully compensate the price increases, and hence, it is likely that the Belarusian machinery exporters in particular will face difficulties in selling their goods abroad. All in all, the energy price hike will have a negative impact on the GDP development, which has experienced an annual growth of around 10% during this decade.

*“As a result of the 12 January agreement, and the earlier deal of 31 December 2006 concerning the new rules of gas trade, Belarus’ GDP may decrease by some 6%, according to estimates by Belarusian experts. The reduction of budget revenue will limit the Belarusian government’s ability to pursue an economic policy based on state interventionism and an extended welfare system. Paradoxically, the restrictions imposed*

---

<sup>4</sup> Mozyr is one of the two oil refineries in Belarus. Over 40% of Mozyr is already owned by Slavneft, a Russian oil company (EIU, 2006).

*by Russia may, in the longer term, help repair the Belarusian economy by forcing the government to do away with central planning in favour of partial opening-up of the market and a liberalisation of economic policy” (Centre for Eastern Studies, 2007c, 3).*

Even if the Belarusian GDP would not dive as much as indicated above, it is certain that **Belarus’ GDP growth rate will drop** considerably from the 10% level. Most probably, the GDP growth slows down even further in the following years, as Belarus is forced to pay even more for its natural gas imports. Here, one should not forget that Belarus is forced to be the Western price of her gas imports from Russia already in 2009.

**Russia’s possible membership in the WTO** in this decade makes the market access of the Belarusian goods to the Russian market more difficult, since Russia’s WTO membership probably introduces tariffs in the trade between Belarus and Russia. Russia’s WTO membership ultimately closes the unofficial trade channel to Russia, which has probably benefited certain oligarchy and even organised crime<sup>5</sup>.

The higher production costs caused by increasing energy prices and the approaching tariff barriers will hamper the Belarusian exports to its main export market, Russia. Currently, Russia accounts for a third of the total Belarusian exports. However, if one excludes the oil exports of Belarus to the West, which are based on the inexpensive oil deliveries and the favourable tariff policy from Russia, the importance of the Russian market becomes even more emphasised in Belarus’ exports. Here, one should keep in mind that over a third of the Belarusian exports consists of oil and oil products, and hence, **Russia represents over a half of the Belarusian exports, if oil trade is excluded from the total exports.**

**Russia’s recent decision to divert oil deliveries** amounting to 50 million tonnes via Primorsk on the Gulf of Finland will hurt the public finances of Belarus. Moreover, **the plan to build a natural gas pipeline (Nord Stream)** on the bed of the Baltic Sea diminishes Belarus’ bargaining power visa-vis Russia, since Belarus’ bargaining power as a strategic energy transit route to the West decreases.

---

<sup>5</sup> It needs to be remembered that Belarus has also applied membership in the WTO, but its accession negotiations have not advanced so much (Kurilionak et al., 2007).

Moreover, ***Russia's investments in strategic companies of Belarus***, such as the most important transit company of natural gas, Beltransgaz, and the major oil corporation, Slavneft, certain petrochemical companies, banks, and telecommunication companies, ***weaken Lukashenka's position further, as the number of loyal oligarchs becomes smaller*** (Troika Dialog, 2006; Centre for Eastern Studies, 2007b).

***Increasing energy prices will also erode Lukashenka's popularity***, since he is forced to transfer at least a part of the increased energy bill to the Belarusian households. This year the Lukashenka regime may manage to compensate a larger part of the increase, but in years to come, the public finances hardly allow him to continue the Soviet-type social policies and agricultural subsidies. It needs to be remembered that the agrarian population forms an important part of the Lukashenka electorate<sup>6</sup>.

At the moment, it does not seem likely that Lukashenka is able to continue in power after 2011 when his current presidency expires. If Lukashenka, nevertheless, manages to stay in power, he may aim at strengthening his position by increasing the grip over politics and economy by suppressing the opposition and non-governmental organisation further<sup>7</sup> and restricting the influence of the foreign companies. It is not completely out-ruled option that Lukashenka suddenly decides to nationalise the strategic energy-related corporations, despite the agreement of selling a majority of Beltransgaz to Gazprom by 2011. Obviously, the nationalisation would lead to serious politico-economic conflict with Russia, and possibly stopping energy deliveries to Belarus.

Here, one should mention that Belarus imports all of her natural gas and oil from Russia. Moreover, the quantities are significant<sup>8</sup>. For example, Belarus' natural gas imports from

---

<sup>6</sup> In May 2007, the Belarusian parliament approved draft welfare reform, which envisages a reduction or complete abolition of welfare benefits available to many social groups. The proposed reform is a radical move that will hit Lukashenka's core electorate (Centre for Eastern Studies, 2007e).

<sup>7</sup> The position of the non-governmental organisations (NGOs) has become even more difficult during the past few years. One indication of the worsening situation is the fact that there are only 1200 NGOs in Belarus, whereas in 1994 their number was three fold. Even more indicative is the fact that during the first three quarters of 2006, no new NGOs were registered in Belarus.

<sup>8</sup> Belarus imports some 20 billion cubic meters of natural gas from Russia, and hence, the hike of natural gas price from USD 47 to USD 100 per 1000 cubic meters increases Belarus' natural gas bill by USD 1 billion in 2007. In 2009, when Belarus is forced to pay the full market price for gas, the natural gas bill will be around USD 4 billion higher than in 2006. Such an increase definitely has an

Russia are equivalent to those of Italy and Turkey. In other words, the Belarusian economy is intensively run on the Russian natural gas. In 2005, Belarusian oil imports from Russia amounted to nearly 19.5 million tonnes, and exports from Belarus to European markets reached close to 13.5 million tonnes. Besides, Belarus exported almost 1.5 million tonnes of crude oil. It is estimated that the Russian companies may account for 60% of Belarus' total exports (Centre for Eastern Studies, 2007d).

Belarus counterbalances her overdependence on the Russian energy and other natural resource deliveries with the fact that she is an important transit country of the Russian oil and natural gas<sup>9</sup>. From her part, Russia decreases the strategic importance of Belarus as a transit country by diverting the oil deliveries totalling to 50 million tonnes from the Russian town of Unecha, near the Belarusian border, to Primorsk located close to the Finnish border. In 2006, the Druzhba pipeline carried some 63 million tonnes of Russian oil, accounting for 28% of Russia's total oil exports. In addition, Transneft uses this route to transport Caspian oil. In January-November, the total volume of oil transit via Belarus to the West reached around 71 million tonnes (Centre for Eastern Studies, 2007d).

Some 15% of the Russian natural gas exports towards the West go through Belarus (Centre for Eastern Studies, 2006). This has been one of the major reasons, why Russian natural gas giant has been so eager to acquire Belatransgaz, which is responsible for the major share of natural gas transit from Russia via Belarus to the EU<sup>10</sup>. In other words, the Belarusian leadership will lose its trump card in the game with Russia by 2011, since then Russia controls natural gas transit via Belarus and receives an increasing part of the oil transit income via Belarus.

---

impact on both the Belarusian state budget and competitiveness of the Belarusian goods outside the domestic markets. In evaluating the impact of the energy price increase, one should keep in mind the small size of the Belarusian economy. The Belarusian GDP was only USD 35 billion in 2006 (EIU, 2006).

<sup>9</sup> The Druzhba pipeline is Russia's main oil export pipeline and it supplies around 12.5% of the EU's oil consumption (AFP, 2007).

<sup>10</sup> Gazprom transports gas to Europe via the Belarusian section of the Yamal-Europe pipe, with a capacity of 25 billion cubic metres a year, and through pipelines owned by Beltransgaz with a capacity of over 50 billion cubic meters. Gazprom already controls the Yamal-Europe pipeline, and receives control over Beltransgaz within four years.

Should the Belarusian leadership decide to nationalise the companies involved in the energy transit, it would obviously lead to a major economic conflict between Belarus and Russia. Probably, the intensifying conflict would obviously bring the destiny of ***the Russian military units in Belarus*** to the discussion<sup>11</sup>. This discussion might be more topical than earlier, as the USA aims at building parts of the missile defence system in the Czech Republic and Poland.

Should the debate on the Russian military units in Belarus arise, it would be completely a military-political issue, since economically it does offer Belarus a bargaining chip in the on-going negotiations. As a sign of its modest economic significance is the fact that Russia pays Azerbaijan only USD 7 million for the use of a radar similar to the one in Belarus (EIU, 2007).

If the Belarusian relations with Russia are broken, and the Lukashenka regime is unable to get support from the West, this would lead to ***the North Korean model***, i.e. to the isolation of the country, deteriorating living standards, and finally to the societal turbulence. The adoption of the North Korean model would not offer Lukashenka a sustainable path for political survival, because the North Korean model would end up in coup d'état sooner or later. The adoption of the North Korean model is not likely, since the Belarusian leadership and the business elite in particular understands that Belarus cannot isolate herself from both Russia and the EU.

Therefore, Lukashenka has already by now started to approach the EU in order to balance the fast increasing Russian leverage. The adoption of ***the European model*** would require Lukashenka to allow a political reform to take place in the country. This model would also require rapid privatisation, as the EU cannot support ineffective state run economy for long. Besides, the implementation of the European model would require considerable financial and technical aid programme from the EU and other international financial institutions.

---

<sup>11</sup> Two Russian military bases operate in Belarus, one in Vileyka and another in Gantsevichi near Baranovichi. The base in Gantshevichi has a Volga radar station, which is a part of the Russian Missile Attack Warning System. It is operated by nearly 2000 Russian military personnel. Correspondingly, the base in Vileyka has a naval communication system (the Antey radar station) with approximately 350 Russian military persons (Centre for Eastern Studies, 2007a).



As the adoption of the European model would also mean that Lukashenka would lose his power and perhaps face legal charges due to his actions against opposition leaders and representatives of media, he may seek for the asylum from friendly-nations, such as Iran or Venezuela, or aim at introducing ***the Chinese model***, i.e. to start the economic reform accompanied with gradual political liberalisation.

It is uncertain how the EU would react to the gradual liberalisation of political life in Belarus. Obviously, the EU does not want to end up in a similar situation, where Russia was a decade earlier, i.e. the EU wants to avoid the endless bargaining from the Belarusian side in order to gain benefits from the EU in exchange of modest political liberalisation.

Russia's reaction to the Chinese model would probably be negative as it might feel that Belarus is moving from its sphere of interest towards the EU. Russia's fear of Belarus ending in the EU's sphere of interest is highly over-dramatised since it is clear that Belarus cannot access the EU without a thorough political liberalisation and economic reform.

The approach of Belarus towards the Union would take years, if not even decades. Here, one should remember that Belarus has hardly advanced in her political and economic reform from what it was at the beginning of the 1990s. Besides, it should be remembered that it took some 15 years from the most advanced post-socialist countries to access the Union. Belarus is not likely to advance as quickly, even if the country's leadership would change and the economic shock therapy would not result in large societal dissatisfaction, which would slow down the economic reform. The Estonian type ultraliberal transformation is highly unlikely, as it might result in social chaos in Belarus, where the majority of the population has been used to a state-subsidised way of living. Paradoxically, too fast a transformation might even stop the whole liberalisation process, since the Belarusian population would be dissatisfied with the economic results of the politico-economic liberalisation (Kurilionak et al., 2007). The dissatisfaction might push the population to vote for those political forces, which support more gradual transformation or even those political forces, which support the integration into Russia.

Besides, the EU's preparedness to continue with the enlargement outside the Balkan region is becoming lower due to the growing resistance from the member states towards further enlargement. On the other hand, if Belarus would be successful in carrying out political reforms, she could start her accession negotiations already in next decade, though the membership would be a matter of the 2020s, even if the reform process would be fast.

For Russia, ***the model of the Karelian Republic*** could be the most desirable outcome<sup>12</sup>. Russia most probably insists that Belarus would become one of the Russian regions with a certain special status. The union state between two equal states is not an option any longer. At the rhetorical level, the integration could be explained to the Belarusian population as the state union, but in real terms, Russia will not accept the integration of two equals.

If the Karelian Republic scenario comes to existence, it can be expected that the Kremlin use strong measures to replace the Lukashenka regime and the Belarusian business oligarchy, and replaces them with more obedient leaders to the Kremlin.

Lukashenka may be tempted to choose the Karelian Republic scenario, if he gets guarantees that legal charges are not placed against him due to mistreating the opposition leaders. In the Karelian Republic scenario, he could stay in Belarus, even if without real political power. For the contemporary Belarusian business elite, the Karelian Republic scenario would mean turbulent times, since it is clear that the Kremlin would select political elite and support the formation of new oligarchy loyal to the Kremlin.

Its is also possible that Belarus starts with the Chinese model, and thereafter, continues with the European model, the model of the Karelian Republic or non-dependent country in-between depending on whether Lukashenka stays in Belarus or leaves the country.

The main parties influencing the future development of Belarus outside the country are the EU and Russia. These parties use different methods of influence and have rather

---

<sup>12</sup> "Unification with Russia would be supported by 45.4% of respondents and 34.2% would oppose it. At the same time, 36.5% of respondents were for EU membership and 41.3% were against it. The underdeveloped national identity is one of the key reasons why the independence of the state is given such a low value. For 48.5% of respondents, improvement of Belarus' economic situation is more important than its independence" (Centre for Eastern Studies, 2007a, 12).

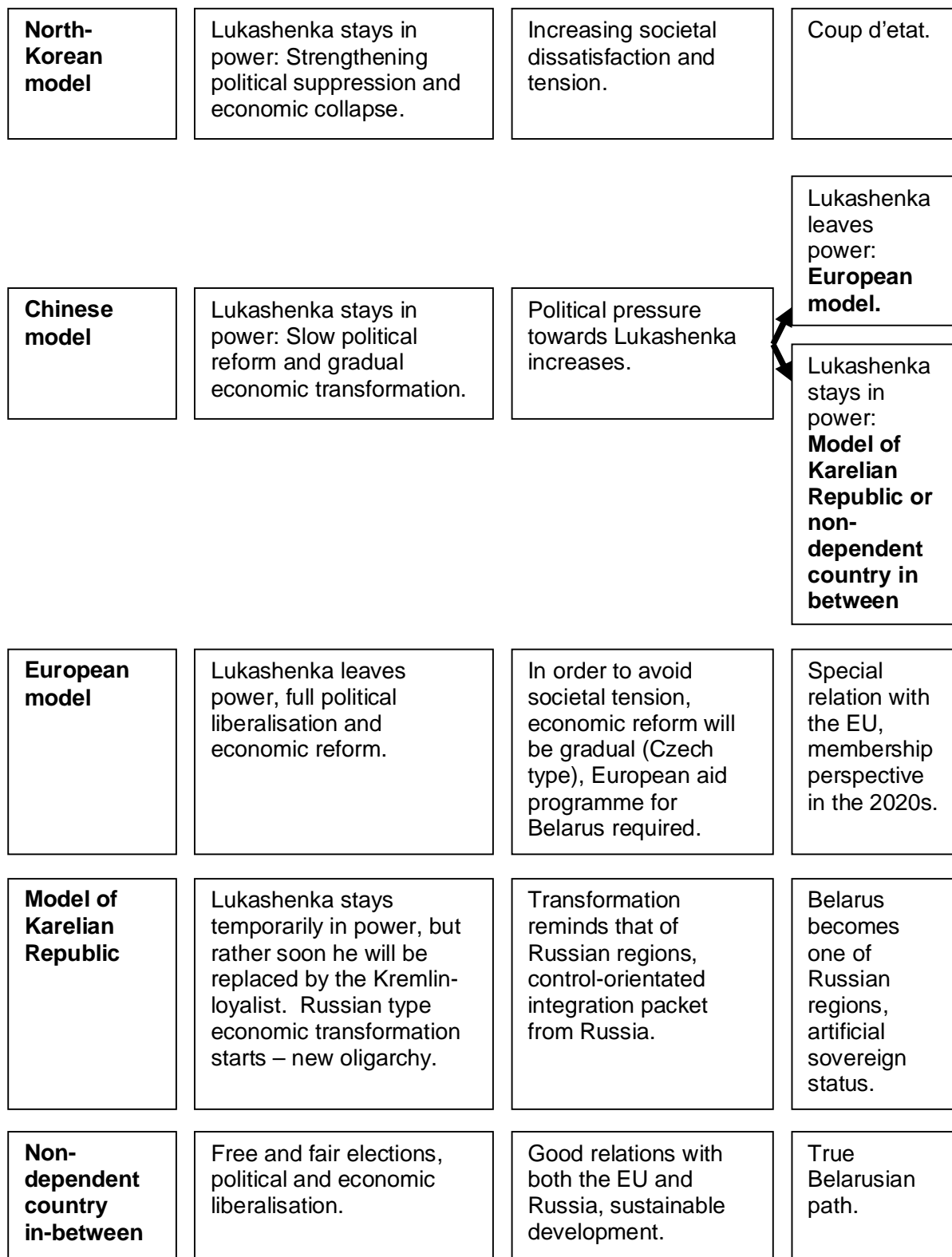
competing goals. These competing goals should be transformed to common understanding that Belarus is ***a non-dependent country in-between***, i.e. it does not belong neither to the sphere of influence of Russia nor the EU.

A successful non-dependent country in-between status requires that Belarus is reliable partner for both the EU and Russia, otherwise, it may transform to a major barrier hindering the economic collaboration between the EU and Russia. One-sided reliability does not transform Belarus into a bridge but rather a new “Iron Wall” between the East and the West. The two-sided reliability needs the democratisation of Belarus, otherwise, Belarus remains unpredictable partner for both the EU and Russia. Therefore, the EU and Russia should have a common goal over Belarus, i.e. forcing political and economic liberalisation of Belarus (see Table 1 and Figure 1).

**Table 1. Belarus' main future alternatives**

<b>Scenario</b>	<b>Domestic policies</b>	<b>Foreign relations</b>	<b>Economic outcome</b>
<b>North Korean model</b>	Lukashenka stays in power, authoritarian governance strengthens.	External relations limited with rogue states, foreign trade & foreign investment non-existent.	Economic stagnation, coup d'état approaches, the Belarusian becomes Iron Wall between the East and the West.
<b>Chinese model</b>	Lukashenka stays in power, delayed political liberalisation, gradual reform, privatisation outside strategic sectors.	Balancing between Russia and the EU, Russian investment dominate, gradual approach towards the EU starts.	Enhanced economic growth due to privatisation, pressure on larger economic and political liberalisation grows, non-sustainable model in long run, though very likely in short run.
<b>European model</b>	Lukashenka leaves power, political liberalisation, full privatisation.	Open & EU-oriented foreign trade, increasing FDI inflow from West.	Early turbulence due to starting of reform, formation of true competitiveness, sustainable growth.
<b>Karelian Republic model</b>	Lukashenka remains temporarily in power, he is replaced soon with a Kremlin puppet, artificial sovereign status within Russia, move of power from Minsk to Moscow.	Trade with Russia becomes domestic, Belarus becomes part of Russia's foreign policy, shadow imports via Belarus to Russia stopped, peripheral target for Western investors.	Dissatisfaction of of people with regional status, economic growth takes place but it is lower than Russian average.
<b>Non-dependent country in-between</b>	Free and fair elections, political liberalisation, economic reform.	Good relations with both the EU and Russia, increasing foreign trade and foreign investment.	True Belarusian path, bridge between the EU and Russia, sustainable economic growth.

**Figure 1. Future scenarios for Belarus**



## References

AFP (2007) *Belarus to increase transit fee for Russian oil*, AFP 6.2.2007.

Centre for Eastern Studies (2006) *The Russian gas for Europe*, Centre for Eastern Studies, Warsaw.

Centre for Eastern Studies (2007a) *Belarus 2006*, Centre for Eastern Studies, Warsaw.

Centre for Eastern Studies (2007b) Belarusian government seeks loans and investments, *EastWeek - Analytical Newsletter* 9/74, 1 March 2007, Centre for Eastern Studies, Warsaw.

Centre for Eastern Studies (2007c) End of the Russian-Belarusian oil conflict, *EastWeek - Analytical Newsletter* 3/68, 18 January 2007, Centre for Eastern Studies, Warsaw.

Centre for Eastern Studies (2007d) Russia stops oil transit through the Druzhba pipeline, *EastWeek - Analytical Newsletter* 2/67, 10 January 2007, Centre for Eastern Studies, Warsaw.

Centre for Eastern Studies (2007e) Belarusian parliament approves draft welfare reform, *EastWeek - Analytical Newsletter* 21/86, 31 May 2007, Centre for Eastern Studies, Warsaw.

EBRD (2006) *Transition report*, European Bank for Reconstruction and Development, London.

EIU (2006) *Country report: Belarus*, December 2006, Economist Intelligence Unit, London.

EIU (2007) *Country report: Belarus*, March 2007, Economist Intelligence Unit, London.

Kurilionak Kiryl, Vassilevsky Stanislav and Medvedev Vitaly (2007) *The Consequences of WTO Accession for Belarus*, wiiw Research Reports 334, The Vienna Institute for International Economic Studies, Vienna.

Lawson Colin W. (2003) Path-dependence and the economy of Belarus: the consequences of late reforms, In *Contemporary Belarus – Between Democracy and Dictatorship*, Ed. by Korosteleva Elena A., Lawson Colin W and Marsh Rosalind J., RoutledgeCurzon, London, pp. 125-136.

Marples David R. (2003) History and politics in post-Soviet Belarus: the foundations, In *Contemporary Belarus – Between Democracy and Dictatorship*, Ed. by Korosteleva Elena A., Lawson Colin W and Marsh Rosalind J., RoutledgeCurzon, London, pp. 21-35.

Troika Dialog (2006) Gazprom and Belarus heading for compromise on gas price?, *Russia Market Daily*, 26.6.2006, Moscow.

Virta Kaija (2007) Lukasenka esiintyy marttyyrina annettuaan periksi kaasukiistassa, *Helsingin Sanomat* 3.1.2007.

## **2007**

8/2007

**Liuhto, Kari (ed.)**

External economic relations of Belarus

7/2007

**Kaartemo, Valtteri**

The motives of Chinese foreign investments in the Baltic sea region

6/2007

**Vahtra, Peeter - Pelto, Elina (eds)**

The Future Competitiveness of the EU and Its Eastern Neighbours

5/2007

**Lorentz, Harri**

Finnish industrial companies' supply network cooperation and performance in Russia

4/2007

**Liuhto, Kari**

A future role of foreign firms in Russia's strategic industries

3/2007

**Lisitsyn, Nikita**

Technological cooperation between Finland and Russia: Example of technology parks in St. Petersburg

2/2007

**Avdasheva, Svetlana**

Is optimal industrial policy possible for Russia? Implications from value chain concept

1/2007

**Liuhto, Kari**

Kaliningrad, an attractive location for EU Investors

## **2006**

11/2006

**Lorentz, Harri**

Food supply chains in Ukraine and Kazakhstan

10/2006

**Hannula, Kaisa-Kerttu**

Doing business in Ukraine - Experiences of two Finnish companies

9/2006

**Uiboupin, Janek**

Industrial clusters and regional development in Ukraine: the implications of foreign direct investments and trade

8/2006

**Avdasheva, Svetlana**

Russian furniture industry: Enterprises' upgrading from the value-chain Theory perspectives

7/2006

Food industry value chains in Leningrad oblast and Krasnodar krai  
(Finngrain – Vilja-alan yhteistyöryhmä)

6/2006

**Zashev, Peter – Vahtra, Peeter**

Kazakhstan as a Business Opportunity – Industrial Clusters and Regional Development

5/2006

**Keskitalo, Päivi**

Internationalisation of Finnish Environmental Technology to Poland

4/2006

**Heiskanen, Katja**

Internationalisation of Finnish Small and Medium-sized Companies towards the New EU Member States in the Baltic Sea Region

3/2006

**Zashev, Peter**

Belarus as a Business Opportunity?

2/2006

**Johansson, Linda**

International Business Operations of Companies with Russian Involvement in Southwestern Finland

1/2006

**Vahtra, Peeter**

Expansion or Exodus? - Trends and Developments in Foreign Investments of Russia's Largest Industrial Enterprises

## **2005**

10/2005

**Hannula, Kaisa-Kerttu**

Host Country Determinants and Investment Motives of Finnish FDI in the Publishing Sectors of Bulgaria and Romania

9/2005

**Vahtra, Peeter**

Russian Investments in the CIS - Scope, Motivations and Leverage

8/2005

**Liuhto, Kari - Zashev, Peter - Heiskanen, Katja (ed.)**

The Approaching EU Accession of Bulgaria and Romania - New Opportunities for EU Enterprises

7/2005

**Liuhto, Kari (ed.)**

Kaliningrad 2020: Its Future Competitiveness and Role in the Baltic Sea Economic Region

6/2005

**Levando, Dmitry**

Investigation into the Structure of Reasoning in Economics

5/2005

**Vahtra, Peeter - Pirilä, Hannu - Hietanen, Satu**

ICT-sektori Baltiassa ja Puolassa



4/2005

**Zashev, Peter**

Between the Co-competitors: Belarus, Moldova and Ukraine Economic Integration in a Bi-polar Europe

3/2005

**Pirilä, Hannu**

Baltian ja Puolan taloudet vuonna 2004 - EU-jäsenyyden ja nopean talouskasvun vuosi

2/2005

**Liuhto, Kari - Vincze, Zsuzsanna (ed.)**

Wider Europe

1/2005

**Lisitsyn, Nikita E. - Sutyryn, Sergei F. - Trofimenko, Olga Y. - Vorobieva, Irina V.**

Outward Internationalisation of Russian Leading Telecom Companies



pan - european institute

[www.tse.fi/pei/pub](http://www.tse.fi/pei/pub)