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Perspectives of Belarus in
the Eurasian Economic Community customs union
(master thesis)

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Statement

I declare that the thesis on the topic “Perspectives of Belarus in the Eurasian Economic Community customs union” I developed on my own. All literature and background materials are mentioned in the attached bibliography.

In Prague

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Signature

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Abbreviations

AA – Association Agreement

CCC –common customs code

CES – common economic space

CIP – consumer price index

CET – common external tariff

CIS – the Commonwealth of Independent States

CM – common market

CU – customs union

DCFTA – Deep and Comprehensive Free Trade Area

EAU – the Eurasian Union

EBRD – The European Bank for Reconstruction and Development

ECU –the EurAsEC Customs Union

EurAsEC – the Eurasian Economic Community (EAEC or EurAsEC)

EEC – the European Economic Community

EU – the European Union

FDI – foreign direct investment

GATT – the General Agreement on Tariffs and Trade

GDP – gross domestic product

NAFTA – the North American Free Trade Agreement

OECD – the Organization for Economic Co-operation and Development

ROO – rules of origin

RTA – regional trade agreement

SCT – single customs tariff

USSR – the Union of Soviet Socialist Republics

WTO – the World Trade Organization

Introduction

Economic shocks that nowadays alternately emerge in different countries and lack of any tangible results in overcoming economic crisis are forcing politicians to turn to the joint running of the economies and the idea of economic and political integration. The idea of unification of economic and trade policies in a single interstate unit has long traditions and has long been successfully applied throughout the world, including the most economically developed countries of Europe and North America. The broad international, economic, trade, monetary and financial integration in Western countries are largely required for its stability and sustainable development. The first steps though to solve common economic problems are liberalization of mutual trade and development of a common customs policy.

In the world economic history evolved a range of economic integrations, all varying in the scale of cooperation and interdependence between member states. One of the types of those economic blocs is a customs union that eliminates trade barriers between participating countries and creates single customs tariff aimed to protect the common market from foreign competitors. World experience shows this kind of integration creates favorable conditions for the development of trade and production, contributes to the strengthening of not only economic, but also political relations between member states that share common economic interests. The European Union, for example, which achieved significant level of economic and political integration, historically began as a customs union. It was exactly the European Economic Community (EEC) created by agreements in Paris (1951) and Rome (1957) that became a springboard for further European integration and the beginning of a united Europe. Although this process was not smooth and easy, political will and desire to find a compromise and common economic goals signed on the final success of the union.

Similar path of close political and economic integration was chosen by countries of the former USSR after obtaining their independence. The first serious step towards integration was made in 1995 through signing of the treaty establishing a customs union between Belarus and Russia and the treaty establishing the Union State of Russia and Belarus in 1999, which envisaged the creation of a common economic space based on the

unification of physical and intellectual potential of two countries and the use of laceration mechanisms in the functioning of the economy. The next step was the formation of the Common Economic Space of Belarus, Kazakhstan, Russia and Ukraine in 2003, which was expected to focus on economic cooperation between these countries. Positive economic development of member countries and significant increase in mutual trade turnover led on 27 November 2009 to signing of further integration agreement – Agreement on the establishment of the EurAsEC Customs Union (also known as the Customs Union of Russia, Belarus and Kazakhstan) with full effect from July 1, 2010. The union was supposed to become one of the possible solutions of unfavorable economic situation tied to the global economic crisis and create a common market for 170 mio people with much greater possibilities of development within a single economic space.

Although the pioneer of study about economic integration Jacob Viner (1950) was of the opinion that regional trade arrangements would cause either trade creation or trade diversion¹, it is now generally accepted that trading blocs usually contain elements of both simultaneously. However, this simple theory, which has since been reworked and criticized many times, provides a basic framework for the analysis of whether members or non-members of a trading bloc benefit from such an agreement. The basic distinction between trade creating and trade diverting impacts of regional trading arrangements remains an essential component of the theory of regional economic integration and customs union theory. Though at first sight regional trade agreements (RTAs) are quite positive trade formations and they always claimed to be so by initiators. Nonetheless, theory suggests that effects of RTAs should be in many respects controversial through different positive and negative impacts.

The current research considers the creation of Customs Union of Belarus, Russia and Kazakhstan and its impact on the economy and trade flows of Belarus particularly. Main goals of this Union are the following: creating the unified customs system under the control of the Customs Commission for trading with countries outside the Union and removing all customs inside the Union. This particular CU² has some features which distinguish it from the rest of the RTAs and increase the importance of the current study:

¹ VINER, J. *The Customs Union Issue*. New York: Carnegie Endowment for International Peace, 1950. ISBN-10: 0199756120

² Here and further in the text: the EurAsEC Customs Union (also known as the Customs Union of Russia, Belarus and Kazakhstan) if comes from the context.

- members were subjects of one country for a long period of time;
- very close economic ties among members;
- severe political underlying basis;
- large disproportion in size of members;
- tariffs of the largest member are basis for common tariffs.

More than three years passed already since the CU was found, but it is still difficult to objectively evaluate the consequences of the signed agreement for each of the member states. Firstly, it is quite a short period of time to statistically analyze appeared positive and negative results of the integration. In addition data analysis is complicated by statistical distortion caused by the global economic crisis. Secondly, in terms of unification of such unequally sized economies and obvious economic and political dominance of Russia in the region, other aspects that have an immediate impact on the decision about the future of integration should be also taken into account. The main of these aspects – geopolitical – must be analyzed from a different perspective and what is also important in aggregate with other factors.

In my case, I was specifically interested in the economy of Belarus that showed phenomenal economic success in 2000s when its annual economic growth made up 9-10 % averagely. However, after 2009 Belarus' economic performance significantly deteriorated and led to dramatic consequences during global economic crises in 2009 and national financial crisis in 2011. I want to find out which effects had Belarus' membership in the CU on its economy and which perspectives are waiting for it in the future. That is why my master thesis is devoted to the multifaceted analysis of the current and future impacts of the CU for Belarus together with assessment of major economic and politic issues that will determine the development of the country in the future. To formulate my initial hypothesis I would like to cite Russian economists. *“The creation of the Customs Union will allow increasing GDP for member countries by 19 % by 2015 year”* – announced academician of RAS³ and executive secretary of the CU Commission Sergey Glaziev⁴. Based on these optimistic claims, on my mind arises the hypothesis that the Customs Union of Russia, Belarus and Kazakhstan seems to have extremely positive influence on welfare of Belarus and other member countries. However, due to specifics of this particular trade formation

³ Russian Academy of Science.

⁴ State Customs Committee of Belarus. [online]. [cit. 2014-04-18]. Available from: <http://www.customs.gov.by/ru/press-center/news/sozdanie-tamozhennogo-sojuza-pozvolit-trem-stranam-poluchit-k-2015-godu-prirost-vvp-na-urovne-19-i-2196.html>

the results can be rather unpredictable. First, partial gains from trade creation have already taken place because of gradual integration of Belarus and Russia that started in the middle of 1990s. Second, a common customs code is mainly based on Russian duties which are general higher than in Kazakhstan or Belarus, and, moreover, since the level of lobbying is quite high in Russia, tariffs are apparently based on the protection of Russian domestic producers. Finally, the number of participating states is quite small and overlapping of countries' economies is quite low, and even for those overlaps production costs are not considerably different, which means that there is not enough space for flourishing of trade creation effects.

Thus, the hypothesis of general benefit of Belarus' participation in the CU will be thoroughly examined and either approved or rejected. For this purpose I will analyze the development of Belarus' major economic and foreign trade indicators before and after entering the Union. Nevertheless the official launch of the CU' was on January 1, 2010, our analysis will start from 2008 – the year which was succeeded by vast economic crisis and plunge of all major macroeconomic indicators. Thus, we will partially eliminate chance of statistical distortion and take into consideration consequences of global economic crisis. For analysis of Belarus' economic performance in this period I will mostly take into consideration following annual indicators:

- GDP growth rate and other connected macroeconomic indicators which will show us general development of Belarusian economy before and after entering the Union;
- imports/exports and its growth rate in order to see the general tendency of the development of Belarus' foreign trade before and after its accession to the CU;
- development of percentage ratio of imports/exports from inside and outside the CU in order to see how application of the single customs tariff (SCT) affected trade creation/trade diversion in the area;
- additionally I will analyze development of the foreign investment inflows to Belarus before and after its entry to the CU as well the impacts of common customs policy on Belarusian state budget.

The paper will also comprise comparative qualitative and quantitative analyses of foreign trade relations between Belarus and its main trade partners and will give realistic forecast of the future integration process as a whole, as well as the view on the impacts of the CU on the national economy of Belarus as the main subject of the research. Except introduction and conclusion, the work will consist of 7 parts.

In the first part I will describe the nature of different types of economic integrations and justify the effect of the customs union on the economies and welfare of the population of participating states.

In the second part I will briefly characterize development of members of the Commonwealth of Independent States (CIS) after the collapse of the USSR to the present time, their attempts of economic and political integration, including description of the stages of forming the CU.

In the third part I will thoroughly describe the principles of the CU integration process, list the main documents establishing the CU, political and economic rationales of member states, the union's economic policies and perspectives of further enlargement.

The next part will give a brief report about development of Belarus' economy since it got its independence in 1991, analyze its recent macroeconomic and foreign trade indicators, describe the structure of Belarus' trade with its main partners and define the role of each country for Belarusian economy.

The fifth section will give statistical analysis of Belarus' economic performance in the CU including evaluation of its impacts on Belarus' membership on its trade flows, level of foreign investments and growth of state budget. We will also mention the consequences of Russia's entry to the WTO and its political influence on neighboring countries.

The sixth part will be based on previously analyzed statistical data and will summarize main challenges that are faced by Belarus's economy and foreign trade which are in one way or another connected to its membership in the CU.

The last part will give a more detailed outlook on the political ground of Eurasian integration and the consequences that it could bring to Belarusian economic and politic guidelines in the future. It will also give a prediction of Belarusian economic development in the nearest future and its consequent politic behavior in the CU.

In my degree work I will frequently use foreign scientific publications, especially those in Russian and English languages. Other sources of relevant information will be articles of both economic and political subject-matter, publications and reports made by international organization and analytical centers, the newest data from media and internet sources. The research will be also amplified with tables and graphs processed predominantly from data available from both national statistical offices of individual CU countries and international statistical organizations.

1. Classification of economic integration

This theoretic part aims to describe the nature of different types of economic integrations and justify the effect of the customs union on the economies and welfare of the population of participating states.

1.1. Stages of economic integration⁵

Economic theory shows free trade on a worldwide basis as the first best outcome, in as much as it allows specialization and exchange to take place globally, thus leading to greater world output and welfare. Preferential trade agreements (PTAs) among a subset of countries are therefore a second best solution. They create trade among their members as trade barriers fall, and they divert trade from efficient non-member producers to members because of their privileged market access. It should be noted that PTAs can take a variety of forms. These range from low-level integration by means of free-trade areas (FTAs) or customs unions (CUs) to higher levels of integration, such as a common market, economic (and monetary) union, or even economic and political union. A PTA also refers to two or more countries forming a union with lower tariffs (and other trade barriers) for goods and services from member countries. FTAs eliminate tariffs on goods from members entirely, and CUs are FTAs with a common external tariff.

More specifically, economic integration proceeds by agreements to:

- abolish tariffs and import quotas among members (FTAs and sectorial FTAs);
- establish common external tariffs and quotas (CUs);
- allow free movement of goods, services and workers (Common Market);
- harmonize competition, structural, fiscal, monetary and social policies (Economic Union);
- unify economic policies and establish supra-national institutions (Economic and Political Union).

Thus three progressively higher levels of integration can be distinguished. The first level entails modest integration by means of an agreement to apply symmetric preferential treatment of imports and assign supporting functions and instruments to jointly operated

⁵ Based on: Western Centre for Economic Research. *Economic integration: free trade areas vs. customs unions*. 2001. Available from WWW: http://www.international.alberta.ca/documents/International/WCER-FTA_custom_unions_shortversion_Aug01.pdf

institutions. Examples would be NAFTA's commitment to eliminate tariffs among its members, its dispute settlement provisions, and the various working groups and committees that serve to facilitate trade and investment among the three partners. In the case of a CU, the agreement would additionally involve a common external tariff applicable to non-members, which, in turn, requires an understanding on how to apportion among the partners the tariff revenue collected.

The second level of economic integration would be the harmonization of instruments over which the parties retain control, and through which, due to different national approaches, obstacles to a common market exist. This could be the case in the area of migration of workers, competition policy, and production standards. One example of such harmonization is the European Single Act. Among other provisions this act applied the "principle of mutual recognition" to product standards. More co-operation and supranational institutions, such as a joint tribunal on competition policy, are also characteristic of this second level.

The third and highest level of economic integration adds coordination of national policies and the creation of further supranational bodies which entail not only economic but increasingly political integration. Examples here are the creation of a common currency and central bank, and even a supranational parliament as in the case of the EU.

Free trade area

This is the preferred option for countries embarking on economic integration and for those unwilling or unable to engage in higher levels of integration. An FTA can be limited to particular sectors, thus retaining a high level of control at the national level and preventing exposure to competition for the other sectors. The authority to decide how third countries are to be treated remains unaffected (independent trade policy) in an FTA. However, rules of origin (ROO) have to be agreed upon among members so as to determine which products can be transferred duty-free. In the case of NAFTA a product has to have been substantially transformed so that a change in tariff classification has occurred, or it must have 50 % (62,5 % for cars) member-country content to qualify for duty-free treatment. There are wide and complex provisions on how such content is arrived at and what documentation is necessary at the border. If there were no such ROO third country products could be landed in the lower duty jurisdiction and then transferred duty-free to the higher tariff member thereby circumvent its tariff. As a result, in an FTA border

controls are necessary for commerce among members, and arguments over interpretation of ROO can lead to delays and disputes.

Customs union

When two or more countries agree to eliminate (essentially) all restrictions on mutual trade and set up a common system of tariffs and import quotas vis-à-vis non-members, the result is referred to as a CU. The adoption of a common external tariff (SCT) and joint quotas necessitates closer co-operation with respect to the sharing of customs revenues collected on non-member imports. Rules of origin are no longer necessary: when a common external tariff exists, imports into the CU-area face the same tariff in each CU-member country, hence there is no incentive for trans-shipment of imports between members. The SCT effectively creates “destination-neutrality” for imports into the CU.

Both FTAs and CUs imply that the member countries remain nation states, yet when viewed in the historical context there are some subtle differences between the agreements. The German Zollverein and the European Community for Coal and Steel are examples of successful CUs. The Zollverein preceded the formation of Germany in 1870 and thus holds fewer lessons for today. The European Community for Coal and Steel, a sectoral CU created in 1951, was not expected to be a precursor to eventual European political union. Nevertheless, it was recognized at the time that free trade and the consequent rationalization and specialization of production in coal and steel products would require a supranational body to regulate pricing practices and commercial policies. This historical precedent therefore suggests that a successful CU implies a common competition policy. Subsequently the European Common Market naturally adopted and extended this competition policy.

A common competition policy would replace the need for, and the application of, trade remedy laws among the CU-members. Predatory pricing (dumping) would be dealt with by the common competition watchdog, and Article 19 of the GATT/WTO could be relied upon to obtain temporary relief from import surges that threaten an industry's survival.

That said, the key feature of a CU remains the SCT. Derivative issues are a matter of negotiation and will determine how successful the CU is.

Common market

A common market (CM) can be considered the first stage of deep economic integration. Free mobility of the key participants in the process of production is its characteristic. In addition to goods and services, capital and people move freely inside a common market. The benefits expected consist of further gains in efficiency through a more appropriate allocation of resources: capital moves to where skills are and people move to where opportunities beckon.

In addition to the common external tariff that defines a CU and to ensure the viability of a common market, uniform regulations have to be worked out among the members regarding the movement of people and capital. This is a major task that requires, at least over time, agreement on qualifications and certifications of workers from different member countries.

For a common market to become effective, therefore, co-operation in decision-making is required in yet more areas. Non-tariff barriers have to be dismantled, structural adjustment policies have to be jointly reassessed, distribution policies will face harmonization pressures, and fiscal and monetary policies, as a dynamic consequence or by design, will show greater convergence. This convergence results from the increased economic interdependence among the members and necessitates that greater consideration be given to the effects of national policies on the welfare of CM partners.

Economic union

The next step in deep economic integration, economic union, adds to the common market harmonized fiscal, monetary and labor market policies. Tax and monetary policies affect where a business locates, and because labor market policies affect migration patterns and production costs, these will have to be streamlined among members. There will be no room for different national transportation, regional or industrial policies, as these distort competition among firms from different member countries.

To achieve such a union, it is necessary to form supranational institutions that legislate the rules of commerce for the entire area, leaving the administration to national bodies, but with recourse to supranational administrative tribunals to ensure uniform application of these rules. In an economic union supranational commercial law replaces national law.

For example, the European Union's (EU) regional adjustment policy provides infrastructure funds to regions within the EU that have 75 % or less of the average EU-income level, with a budget of 0,45 % of the EU's GDP. This illustrates the degree of co-operation necessitated by an economic union.

An economic union is made more effective, furthermore, by a common currency. When there is no uncertainty about exchange rates among members, location decisions and trade patterns will follow efficiency considerations, and borrowing costs will not be affected by an exchange risk premium on a particular member country's currency.

At this level of integration pressures for uniform taxation policies will increase even if agreement on such may prove elusive as shown in the case of Europe. The final outcome of economic union may well be a political confederation with unified economic policies. Economic union will stop short of political union if no supra-national bodies regarding defense and foreign policy are created.

Table 1: Forms of economic integration between states

	<i>Free-trade area</i>	<i>Customs union</i>	<i>Common market</i>	<i>Economic and monetary union</i>	<i>Political union</i>
Duty free movement of goods and services between member countries	yes	yes	yes	yes	yes
The common customs tariff and a common customs policy towards third countries	no	yes	yes	yes	yes
Free movement of capital and labor among member countries	no	no	yes	yes	yes
Common economic and monetary policy among the Member States in certain directions	no	no	no	yes	yes
The unification of all areas of economic policy among the Member States	no	no	no	no	yes

Source: own.

Generally, the various forms of economic integration follow successively each other with the highest degree of unification in economic and monetary union, which is built on the common market while linking economic and social policies of member countries and aiming to develop a common economic policy. Full economic integration implies consequently political integration.

1.2. Effects of a customs union⁶

Customs Union is the major method to achieve a regional economic integration. As was told before, the most important characteristic of a customs union is the complete elimination of tariffs between member countries. Although this provides a movement towards a free trade, it does not provide a global free trade. In the customs union, there is the implementation of a common external tariff and common trade policies against the third countries.

There are two kinds of effects of customs unions, static and dynamic. The static effects relate to the impact of the establishment of the customs union on welfare. Trade effects involve static effects, namely trade creation and trade diversion effects. Trade creation effect can be defined as the replacement of expensive domestic production by cheaper imports from a partner and trade diversion is the replacement of cheaper initial imports from the outside world by more expensive imports from a partner. Customs union has effects on trade, welfare, balance of payments and growth. Effects other than trade effects are mainly dynamic effects which can be summarized as competitiveness, technological development, scale economies, resource allocation and investment.

Static effects of a customs union

Viner (1950) differentiates between two main (static) effects of trade integration – trade creation and trade diversion. In a customs union, trade creation occurs when one product, which had previously been produced in each of the countries, is now produced in one of the CU members which achieves the highest efficiency. Trade creation influences, thus, allocation efficiency in each of the member countries and encourages specialization according to comparative advantage.

Trade diversion results from tariff discrimination of the countries which do not participate in CU. This effect results from the redirection of imports from the third, non-member country (which has lower production costs, but also faces import tariffs of CU) to the member countries whose ‘competitiveness’ results only from the 0 % tariff rather than from better allocation efficiency. Due to the allocation of resources which does not fully comply with the principle of comparative advantage, trade diversion is negative for both

⁶ According to: European Trade Study Group. YILMAZ, S. *The dynamic effects of economic integration: a comparative study on the competitive power of Turkey and EU-8 (Poland, the Czech Republic, Hungary, Slovakia, Slovenia, Latvia, Lithuania and Estonia)*. Gazi University 2008. [on-line]. [cit. 2013-2-21] <http://www.etsg.org/ETSG2008/Papers/Yilmaz.pdf>

the importing and producing country. Therefore, the net effect of CU on the general welfare cannot be unanimously or à priori conferred as it largely depends upon the degree of trade creation and trade diversion.

Because regional agreements can be welfare-enhancing or welfare-reducing, the effects of regionalism depend critically on which country pairs choose to form preferential trade deals. One of the most common theoretical arguments about which country pairs will find preferential trade agreements to be economically beneficial is the natural trading partner hypothesis, which argues that regional trade deals between nearby countries with significant bilateral trade are more likely to be trade creating than trade diverting. As with many other issues in the regionalism debate, there are conflicting theoretical predictions about whether countries will tend to form regional trading blocs that raise welfare. The natural trading partner hypothesis provides an optimistic assessment, with countries tending to sign trade deals that lead primarily to trade creation.

Dynamic effects of a customs union

Besides these static welfare effects, there are several important dynamic effects that CU offers to member countries. These are due to increased competition, economies of scale, stimulus to investment, and better utilization of economic resources. The main reason for that are the long-term effects which result from the possibility of a preferential access to larger market of the union and increasing export possibilities. Market enlargement and stronger competition force producers to reduce production costs and offer them at the same time the opportunity to enjoy the advantages of economies of scale. Thanks to the economies of scale and lower unit costs trade suppression effect occurs. By improving the competitiveness of producers within the union this effect contributes to further reduction in trade with the countries remaining outside the integration.

Other benefits from creation of a customs union

The creation of a CU brings to each member state the various economic benefits. The main benefits (especially for small countries) are subject to economies of scale due to market expansion. Small economies are not competitive enough, either because of lack of production inputs or problems associated with difficulties in covering the cost of production. Customs union combines markets, resulting in the removal of national monopolies and increase of national competition. Increased competition leads to a fall in

prices and increased production. The connection of several countries into one economic unit enables overall market expansion, leading companies to increase production and ultimately to reduce unit costs of production.

1.3. Customs union vs. free-trade agreement⁷

Each of these two forms of economic integration has a distinguishing characteristic that has significant implications. For an FTA, with each country having its own external tariff, the ROO is the distinctive feature. For a CU the distinctive characteristic is the common external tariff (SCT) applicable to third countries.

Economic effects of rules of origin (ROO)

As already discussed, ROO have the purpose of preventing trade deflection, i.e. goods or services entering the member country with the lowest tariff for the purpose of trans-shipment.

A number of negative effects are ascribed to ROO in the literature on economic integration.

1. ROO create incentives for producers to purchase higher cost inputs from member countries to satisfy the origin requirements, thus adding to trade diversion.
2. ROO lend themselves to lobbying by interest groups seeking protection from foreign competitors by demanding stringent ROO that favor component suppliers from member countries over competing firms from third countries.
3. With different input prices in different member countries due to different tariff schedules, producers face different input costs, thus distorting production.
4. ROO tend to be complex. Thus their application results in additional costs and bureaucratic surveillance.

Different criteria, like “substantial transformation,” “change in tariff heading” (CTH), “value-added” or “specified process,” are possible, each bringing its own set of complexities.

The criterion of substantial transformation of a product is rooted in common law and is decided by the courts in the case of a challenge. The CTH criterion is on the surface

⁷ Based on: Western Centre for Economic Research. *Economic integration: free trade areas vs. customs unions*. 2001. Available from WWW: http://www.international.alberta.ca/documents/International/WCER-FTA_custom_unions_shortversion_Aug01.pdf

more objective, but in fact requires specification of what level of tariff headings to be updated with changes in technology. The value-added criterion poses difficulties as it requires agreement on accounting methods and audits. Finally, process-criteria must be specified for each individual product. As a result, interpretation is subjective and substantial room exists for discretion in implementation. The NAFTA, e.g., contains 200 pages of fine print regarding the ROO.

Economic effects of the common external tariff (SCT)

The effects of the negotiated SCT can be summarized as follows:

1. As the negotiations are carried out at the government to government level this reduces incentives for individual lobbies. Once established, a SCT remains non-negotiable. On the other hand, internal pressures, like in the well-known prisoners' dilemma, could result in a higher SCT.
2. In light of the inability to influence the (re)negotiation of the SCT, efforts to increase non-tariff barriers may be observed. Common commercial and trade policies would limit such efforts.
3. There is administrative simplicity in a SCT that makes it easy to implement, and it creates predictability.
4. Input costs will not differ among members solely as a result of tariffs, promoting efficiency and competition.

Based on these differences, Krueger (1995)⁸ has shown that an FTA does not lead to more net trade creation than a CU for the same partners, provided the CU takes into account the levels of higher and lower tariff countries and settles on an average SCT for each commodity.

An FTA also will not be more welfare-enhancing than a CU for the same members, if the SCT is set below the level of the high cost country. In that case, trade is created when the high cost country cuts production in the wake of tariff cuts, whereas an FTA would retain the tariff and create less trade.

Together with the trade-diversion (protectionist) effect of ROO this implies more trade creation and less trade diversion for a CU, hence the conclusion that the potential welfare effects of a CU outweigh those of an FTA.

⁸ National Bureau of Economic Research. KRUEGER, A. *Free Trade Agreements versus Customs Unions*. 1995. Cambridge. [on-line]. [cit. 2014-1-23] http://www.nber.org/papers/w5084.pdf?new_window=1

With borders and separate customs procedures continuing under an FTA, a CU approximates a larger single market. In negotiations with third countries this lessens the power of interest groups compared to an FTA and makes for more pronounced scale economies and pro-competitive effects. Non-members of a PTA will behave in more conciliatory fashion vis à vis an emerging CU than an emerging FTA, as the risks of confrontation with a larger economic unit (market) with common external tariff act as a strong deterrent.

As well, a large enough CU will have an influence on the prices of internationally traded goods, forcing outside countries to accept the prices prevailing inside the CU. Thus the outside countries will export to the CU at prices that include the SCT and transport costs, bestowing an element of monopsony power to the CU. This effect is much less clear for an FTA of similar composition. Therefore, on balance, the economic benefits of a CU outweigh those of an FTA.

Political implications

FTAs are a limited form of integration and by design little sovereignty is compromised, both in economic and political terms. The institutional agreements for an FTA are not extensive: a secretariat as a monitoring device and a forum for ongoing dialogue among members are all that are necessary.

The existence of ROO mitigate against expansion of an FTA in as much as new members need to negotiate new ROO. Each new application for entry provides an opportunity for lobbyists to renegotiate existing ROO, slowing down the process of enlargement in comparison with the given SCT of a CU.

In addition, if a country has membership in two or more FTAs (e.g. NAFTA and the FTA of APEC), different ROO for different FTAs create administrative complexity and customs disputes. It is difficult to envision the emergence of a single market in the face of such complicated access conditions. By contrast, a CU represents tariff-unification by definition. While FTAs mean a continuing administrative presence at internal borders for the purpose of documentation monitoring, CUs foster the borderless movement of goods among members.

As a result the political economy of FTAs is less conducive to further trade liberalization than that of CUs, and the ROO of the former create opacity, complexity and lobbying room for protection. A CU, in turn, requires co-operation in arriving at a SCT and

agreement on a sharing rule for the customs revenue that is actually raised. For future trade negotiations a CU necessitates a harmonized trade policy, and that means an additional loss of sovereignty.

The question then arises as to how much more sovereignty will have to be ceded to arrive at a CU compared to an FTA? The initial negotiations for either an FTA or a CU are not that different in substance: agreement has to be reached on the schedule of implementing free trade among the partners. Adding on the negotiation to unify tariffs towards outsiders is the extra complication for a CU. The number of partners and the differences of national tariff codes will determine the complexity of these discussions. At present WTO obligations dictate that existing schedules are not raised to facilitate a compromise with respect to the SCT. For this reason the deliberations for a CU will be more complex. Just as revenue sharing agreements exist within countries, we observe formula-based voting and international reserve allocation at the supranational level, e.g. at the IMF. It is therefore not inconceivable that an allocation of tariff revenue can be found that mimics international practice elsewhere. Whether or not such an agreement represents a significant loss of sovereignty is a matter for debate.

As mentioned above, one consequence of a CU is that future trade liberalization at the WTO-level will force member countries to coordinate their negotiating position closely with each other: a common stance is necessary for a CU, and this need for a coordinated approach represents an additional loss of sovereignty compared to an FTA.

The foregoing explains why it is politically easier to arrive at an FTA than a CU. Trade creation, an economic gain, is viewed as a loss by domestic industry and by other lobbying groups. Hence they oppose it. Trade diversion is at the expense of external producers, hence does not elicit a negative response. And since free movement of workers is an extremely sensitive issue anywhere, higher degree integration tends to prompt stronger political resistance.

Political feasibility favors an FTA over a CU. The fact that FTAs have a higher potential for trade diversion and no greater potential for trade creation than CUs implies that FTAs are less likely to encounter political resistance. A SCT is difficult to arrive at: it took the EU thirty years to overcome national quotas on clothing, footwear and steel imports. Substantial political will and preparation have to be nurtured for a CU formation. This is made more important by the fact that the economic gains from any PTA tend to be longer run, whereas the adjustment costs tend to occur right away. Not surprisingly, we

rarely observe successful economic integration at a higher level than the FTA. By January 2014, 377 PTAs had been notified to the WTO. Of these only 25 were CUs (World Bank, 2014).

2. Economic and political integration of the CIS countries after the collapse of the USSR

In the following part I will briefly characterize development of members of the Commonwealth of Independent States (CIS) after the collapse of the USSR to the present time, their attempts of economic and political integration, including description of the stages of forming the CU.

2.1. Experience of integration on post-soviet space

After the collapse of the USSR in 1991 former Soviet republics faced the challenge to secure their independence by establishing proper international institutional arrangements of political (security) and economic character. In fact, they had to solve very difficult problem of integration into international political and economic structures. In order to solve this problem they needed quite clear understanding of the national economic and political interests in the long-term perspective. Strong consistency and consequences of nearly 70years united coexistence of the countries signed on numerous subsequent integration projects in the region with a strong dominant influence of Russia which still represents the strongest player among post-Soviet states, not only in terms of size, but also military power and economic potential. Russian leading status is demonstrated through its interference into national policies of the other states of the region and their relations with the outside world.

Along with the formal end of the USSR representatives of Russia, Ukraine and Belarus signed on the creation of a new project of integration – the Commonwealth of Independent States (CIS) which gathered 11 independent republics. The Baltic States refused entry to the CIS and firmly stood on the way of EU and NATO integration. Georgia joined up two years later but finally left the integration after armed conflict with Russia in 2008. The same decision was made by Ukraine in 2014 after Russia annexed the Crimean peninsula. The main obstacle to stable and efficient development of the integration lies in its multiple internal and interstate conflicts that prevent peaceful international relations. Member states may not share common future plans and some have already showed signs of fear of a possible Russian hegemony. As a result of these

difficulties, there has been a division between countries in the CIS region into “closer core”, represented by Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan, and the states that refuse close integration, i.e., Turkmenistan, Uzbekistan and Azerbaijan.

This classification indicates which direction took cooperation within the Community. In January 1995 the Customs Union of Belarus and Russia was established, renamed a free trade zone in 1996. In October 2000 the agreement on the establishment of the Eurasian Economic Community (EurAzEC) was signed, which entered into force in 2001. Despite its name at that time the full member were only Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan. Observer status was assigned to other three post-Soviet republics: Moldova, Ukraine and Armenia. In 2006, their steps were followed by another post-soviet republic – Uzbekistan. In addition to cooperation within WTO entry the main objectives include customs harmonization, development of common rules for the protection of borders, the development of joint programs of economic and social development, creation of comparable conditions for business activities, equal access for citizens of member countries to higher education in other member states and other.

Even the change of name did not lead to more effective economic integration though. Russian government, aware of its strong position, introduced many restrictions contrary to the meaning and essence of a free trade zone. The efforts of the former Soviet republics to maintain coherence even after the collapse of the USSR and create effective CIS integration disrupts a number of factors:

1. inconsistencies in pace of implementation of economic reforms by republics;
2. dependence of most economies on Russian energy supplies;
3. preference of some CIS members to create economic and political relations with countries outside the former Soviet Union.

All these factors in one way or another had an impulse to creation of numerous groups in the Commonwealth of Independent States. One of these groups is the Central Asian Cooperation Organization. The original plan for the formation of the Central Asian Cooperation Organization developed in 1991 was followed by the creation of the Central Asian Union in 1994 by the founding countries of Kazakhstan, Kyrgyzstan and Uzbekistan. During its development it was renamed into Central Asian Economic Cooperation (1998) and joined by Tajikistan. Its final form and official name of a Central Asian Cooperation Organization the integration acquired in 2002. Russia joined it in 2004, while Ukraine, Georgia and Turkey became the observer states.

Also noteworthy is the creation of the Organization of the Collective Security Treaty (CST) in 2002 signed by six former Soviet republics: Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan. This intergovernmental military alliance has its roots in the origin of the Collective Security Treaty of the CIS in 1992. The CST was set to last for a 5-year period unless extended.

On 2 April 1999, only six members of the CST signed a protocol renewing the treaty for another five-year period --Azerbaijan, Georgia and Uzbekistan refused to sign and withdrew from the treaty instead. At the same time Uzbekistan joined the GUAM⁹ group, established in 1997 by Georgia, Ukraine, Azerbaijan, and Moldova, and largely seen as intending to counter Russian influence in the region. Uzbekistan later withdrew from GUAM in 2005 and turned back to the CST for one more 5-year period. GUAM's charter was signed during a summit in Yalta in June 2001 by the four current members and Uzbekistan, which later withdrew. According to the former Ukrainian President Viktor Yushchenko *"the charter set objectives for cooperation, such as promoting democratic values, ensuring stable development, enhancing international and regional security and stepping up European integration"*¹⁰. This act could be taken as a defensive reflex against Russian attempt to limit the independence of the other members of the organization. Currently the active members are 6 post-Soviet states: Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan; the observer status have Serbia and Afghanistan.

Central Asian states except Turkmenistan, along with Russia and the People's Republic of China, are also members of the Shanghai Cooperation Organization, fully qualified since June 2002 by adoption of the Charter of the organization. The purpose and objective of the organization is a security cooperation, settlement of border disputes, prevention of military conflicts, fight against drug trafficking, Islamic extremism and terrorism.¹¹ A Chinese daily expressed the matter in these terms: *"The Declaration points out that the SCO member countries have the ability and responsibility to safeguard the*

⁹ The GUAM Organization for Democracy and Economic Development is a regional organization of four post-Soviet states: Georgia ("G"), Ukraine ("U"), Azerbaijan ("A"), and Moldova ("M").

¹⁰ Newspaper "segodnia.ua". [on-line]. [cit. 2014-2-27] Available from WWW:

<http://www.segodnya.ua/ukraine/jushchenko-racckazal-uchactnikam-huam-o-prioritetakh-orhanizatsii.html>

¹¹ PIVOVAR, E. *Postsovetskoye prostranstvo: alternativy integratsii*. St. Petersburg: Aletya, 2010. ISBN 978-5-91419-095-5

security of the Central Asian region, and calls on Western countries to leave Central Asia. That is the most noticeable signal given by the Summit to the world".¹²

2.2. The road towards establishment of the Customs Union of Russia, Belarus and Kazakhstan

On 9 June 2009, Russian Prime Minister, Vladimir Putin, after his meeting in Moscow with the leaders of Belarus and Kazakhstan, announced that these three states had embarked upon the creation of a Customs Union. At that time, his announcement sounded like a repetition of a slogan which had been heard many times before. After all, as early as September 1993, a group of countries belonging to the Commonwealth of Independent States had signed an agreement which envisaged the creation of a free trade zone to be followed by a customs union and later an economic union. This was expected to be a gradual process of a new (re)integration of this area. Furthermore, in January 1995, a customs union agreement was signed by Russia and Belarus, soon to be joined by Kazakhstan, and then in 1996 by Kyrgyzstan and in 1999 by Tajikistan.

However, too many factors were working against the integration process. It was initiated by Russia, which had from the very beginning aspired to play the role of hegemon in the post-Soviet area. The process was formally supported by such countries as Belarus, Kazakhstan and the remaining Central Asian countries, which were strongly connected to Russia (and some of which were even economically dependent on it), to whom the ongoing disintegration of economic bonds meant the greatest losses. However, even they had a different vision for integration than did Russia, and were using this process for their own needs, as a means to solve their current problems. Many of these countries, like Ukraine, saw these agreements more as a way to distance itself from the former USSR rather than a transition to a new kind of community. They were focused on turning themselves into independent states, also in economic terms.

Nevertheless, paradoxically, Russia itself was the main cause of the failure of integration efforts at that time. It had to deal with an economic crisis and carry out painful reforms; so it really did not want to bear the costs of what effectively was subsidizing the economies of the other CIS countries, most of which had chosen other economic policy

¹² Newspaper "People's Daily". [on-line]. [cit. 2014-2-27] Available from WWW: http://english.people.com.cn/200507/08/eng20050708_194907.html

models based even less on free market principles. Nor could it really afford this. For this reason, the ruble zone collapsed in summer 1993, when the monetary reform in Russia forced other CIS countries to introduce their own national currencies, even though some of them had not planned to do so. It was also Russia which in fact blocked the implementation of the free-trade zone agreement signed in 1994 by most of the CIS countries.

Furthermore, a number of Russian initiatives – including the customs union project in 1995, and especially the subsequent agreements with Belarus (1996, 1997, 1999) envisaging the creation of a kind of a union state – were in fact superficial political and propaganda actions aimed at rescuing the reputation of President Boris Yeltsin, whose popularity in Russia had been weakening.

These factors, along with the deepening differences in interests and development levels, the lack of basic trust, the use of protectionism to cushion the weak economies, which were unprepared to face competition, meant that despite the numerous agreements signed, the 1990s were in fact a period of accelerated disintegration of what had been a uniform economic area in the Soviet period.

A breakthrough was expected when a new, vigorous leader, Vladimir Putin, took power in Russia at the beginning of 2000. Indeed, his coming to power coincided with new initiatives – the countries participating in the customs union signed an agreement in October 2000 setting up the Eurasian Economic Community (EAEC or EurAsEC). However, the implementation of the agreements signed and the construction of the new community's structures (some of which were by definition supranational) again met with great impediments. The states involved had different interests, and they lacked strong economic and political motivation. Russia became the source of economic motivation in response to the launch of a new European Union initiative in 2003, which a year later became known as the European Neighborhood Policy. Moscow saw this as a challenge to its hegemony in the CIS area, which was especially dangerous in the case of Ukraine, a country it sees as strategically significant for many reasons. This was the primary origin of another Russian initiative, the Common Economic Space (CES) of Russia, Ukraine, Belarus and Kazakhstan. The March 2003 declaration and the CES agreement of September that same year, which were signed under political pressure from Moscow, were primarily aimed at pulling Ukraine into the integration orbit. However, this plan was thwarted when political forces reluctant to join the CES took power in Ukraine in 2004 as a

consequence of the Orange Revolution. The process of creating the CES entered a phase of stagnation which lasted until 2009. Then a new economic factor emerged: the economic crisis (from autumn 2008), which dealt a heavy blow to Russia, and an even heavier one to Ukraine. The other countries from the CIS area were also affected, albeit to a lesser extent. It could thus have appeared that establishing closer economic co-operation, trade liberalization and opening up the borders between the key CIS countries would definitely help their economies and accelerate their exit from the crisis. Political stimuli were also present.

In 2009, the EU initiated the Eastern Partnership program (upon a motion from Poland and Sweden), which envisaged the negotiation of EU Association Agreements and Deep and Comprehensive Trade Area agreements (DCFTA) with those eastern partners who had made the most progress in their reform processes (Ukraine and Moldova were the first to start this process). Russia saw this as a new challenge, and wanted to respond to it in a decisive manner. Moscow was also anxious about China's increasing economic expansion in Central Asia, which was undermining Russian influence in the region, including in Kazakhstan, a country of strategic significance for Russia.

This was the essential background for Vladimir Putin's initiative to rapidly build up the Customs Union of Russia, Belarus and Kazakhstan. Another important fact was that Putin was the prime minister at that time, whose formal key prerogative was the economic policy of Russia. The idea of the CU became Putin's flagship project after that time. It was so important that in an attempt to force the EU and the USA to recognize the Customs Union as a partner, he delayed the negotiations concerning Russia's accession to the WTO by over a year.

Yet on the other hand, it seemed that Putin had learnt some lessons from the failures of the previous integration processes in the CIS area. The new initiative differed from the previous ones in several important elements.

- Firstly, the draft agreements were prepared much more carefully. They were significantly more specific and covered a broader scope of issues. Russia's political determination to implement them was also greater.
- Secondly, Russia made clear concessions to its partners in its effort to make them genuinely interested in implementing the agreements. Moscow used the conditionality principle in this case as well, but it also used the principle of greater symmetry of benefits. The impression could have been gained that

Russia was ready to incur significant but temporary economic costs to gain long-term political benefits.

- Thirdly, unlike before, efforts were made to ensure that the CU agreements were based to a greater extent on international standards. In particular, Moscow forced its partners de facto to accept that the provisions of the Customs Code complied with the negotiated protocols setting the conditions for Russia's accession to the WTO. Another characteristic feature was the similarity (at least on a formal level) of the names and institutional solutions of the initiatives originating from Russia and the European Union.

What the new initiative and the previous ones had in common was the supposition that it would be implemented phase by stage, as well as the great ambitions of the project, which from the Customs Union would soon lead to the creation of the Common Economic Space and later the Eurasian Economic Union. It was also clear from the very beginning that one of Russia's key political goals was to make Ukraine part of the new structure. As we can see from the latest political affairs and demission of pro-Russian regime of Yanukovich in the beginning of 2014 optimistic plans of Putin towards Ukraine did not justify themselves.¹³

¹³ Based on: WISNIEWSKA, I. *Eurasian integration: Russia's attempt at the economic unification of the post-soviet area*. Warsaw: Centre for Eastern Studies, 2013. [on-line]. [cit. 2014-1-21] Available from WWW: http://www.osw.waw.pl/sites/default/files/prace_44_eurasian-integration_net.pdf

3. Creation of the Customs Union

After have analyzed the stages of political and economic integration that took place on the CIS space after breakdown of the USSR, we came in earnest to the whole process of creation of the EurAsEC Customs Union. Thus, this part will be thoroughly devoted to detailed description of the process of integration and will comprise such topics as political rationales of the member states, legal aspects of integration, principles and policies of the CU and its common economic space as well as perspectives of enlargement of the union and analysis of potential effects that could experience Belarusian economy after it joined the CU.

3.1. The political rationales of member states

For many Western observers, the EurAsEC Customs Union is a purely political initiative – Moscow’s new attempt to rebuild its empire. Some suggested that the creation of the customs union was a tactical move and a pretext to delay Moscow’s negotiations on World Trade Organization (WTO) accession. At one point, Russia proposed that the three enter the WTO as a group – that is, the customs union, not the individual countries, would join. The move caused havoc in Geneva and was ultimately rejected. Others claimed that Russia pushed for the customs union and common economic space to counterbalance the EU’s Eastern Partnership initiative launched in 2007.

While this may partly be true, the project in reality is more complicated. It is in part a product of the geopolitical considerations of Russian leadership and, to a degree, the two other participants. But it is also a very concrete step toward integration.

Russia’s Considerations

Regaining control over the neighborhood. For obvious historical and simply geographical reasons the project is very much about Russia. Moscow is indeed seeking to reestablish its control of the neighborhood. Seen from Moscow, this is a natural course of affairs, but the task is certainly controversial.

It proved difficult to gather all the countries of the post-Soviet space because many of them had already developed their own agendas. The circle of states that could be integrated into a union was thus limited to those whose leaderships had compatible agendas. Still, the way was easier than it could have been in some respects. Russia did not

have much competition from the West for the region, an opportunity Moscow regretted missing.

The customs union is also very much about the economy. Putin's Russia can survive if its resources – both natural and human – are limitless, something the customs union could potentially offer. Otherwise, its dramatically corrupted and expensive system of authorities and subsidized industries and economies will lead the whole country to total economic break-up. That is why for Russia it is crucially important to ensure close economic cooperation with its neighbors that hold the infrastructure used for transit of its mineral exports. Moscow does not have a grand plan to rebuild the production lines that once existed in the post-Soviet space. Rather, Russia's desire to improve the cohesion of its neighborhood, expand its own rules of the game, and gain access to neighbors' resources drives this integration project forward. It is more about a wider exchange of commodities than a new economic model. At the practical level, Russia seeks to limit the reexport of cheaper goods from the EU and China through Belarus and Kazakhstan, controlling exports of raw materials to the EU via Belarus, and getting better market access from Minsk and Astana.

An equal partner. The customs union is, however, more than just a fight for resources. It is meant to have an impact on Russia's global stance. Moscow secretly admires the EU, and the idea of building the Eurasian project on the basis of the European experience demonstrates that admiration.

In addition, Russia wants to be recognized as an equal partner by Brussels. To officials in Moscow (not only Putin), the customs union is a precondition for such a recognition. Moscow projects its own way of doing business onto the European model, thinking that a country can only be seen as equal to the EU if it controls its own neighborhood. And even further, Russia believes that Brussels is more likely to entertain the idea of a free trade area from Lisbon to Vladivostok that was proposed by Putin if it is negotiating with another bloc.

Counterbalancing China. The customs union is also about Russia's quest for an economic presence that can act as a counterweight to a rising Asia. Despite Beijing's status as Moscow's ally, Russia is uncomfortable with China's rise and growing presence in Central Asia. The customs union is thus a way to protect Russia from China with a buffer of friendly countries (now Kazakhstan with Kyrgyzstan and Tajikistan to potentially

follow) and to improve Russia's declining appeal in Central Asia by granting these countries better access to markets.

As it is with the EU, Russia is driven by its own perception of China. Moscow cannot believe that China is pragmatically seeking natural resources in Central Asia without any interest in dominating the region or exporting its economic model there. The customs union is thus a way to counterbalance China, even if for possibly wrong reasons.

Considerations in Belarus and Kazakhstan

Many in the West prefer to see Russia as having coerced other countries to participate in the customs union. While Russia indeed has been attempting to coerce Ukraine into participating, Belarus and Kazakhstan joined the union essentially voluntarily. Minsk has had quite close ties with Russia since 1996, when a customs union between the two countries was first formed, and Astana never hid its interest in Eurasian integration.

The union of three is thus more than just a dominance of Russian interests. Both countries are still run by politicians of the old order, with Aleksandr Lukashenka of Belarus in power for almost 2 decades and Nursultan Nazarbaev of Kazakhstan at the helm since the country's independence. Therefore, their motivation to get closer to Russia is primarily shaped by "the class solidarity of post-Soviet elites" who feel comfortable copying Moscow. Undoubtedly, both leaders hope for more equality within the union and expect Russia to change, but they clearly know what they signed up for.

In the end, their decision to join was purely political. There were hardly any ex ante estimates of the costs and benefits of the entire project and of its impact on individual members. Russia's promises of significant increases in trade flows and a 16 bn USD gain in the first five years – thanks to the elimination of customs duties and cheap gas – were largely groundless.

For Lukashenka, the customs union is a way to help ensure the survival of his regime. In part, he may have been worried that Russia would reinstate a customs regime if Belarus did not join the customs union, as Moscow threatened to do. Yet, Lukashenka's need for financial support to restore his social contract with people that had been undermined by the economic crisis was the main driver of Belarus's decision. Lacking support from the International Monetary Fund and the EU, Lukashenka was forced to seek Russia's financial intervention.

For Kazakhstan, the story is more complicated. Nazarbaev is quite comfortable in Kazakhstan. When the time comes, he is likely to pass the mantle of the presidency to his daughter. The resource-rich Kazakh economy is doing quite well, with the population largely supporting Nazarbaev's policies. For him, the decision to join the customs union was driven by the ambition to be remembered as the father of this project. Indeed, he was the first to coin the term "Eurasian union" back in 1994. In addition, Nazarbaev also sought to counterbalance China, whose presence and influence in Kazakhstan has grown in recent years.

There was little economic rationale behind Kazakhstan's membership. The country's elite and businesspeople voiced their concerns before the launch of the union, though few listened. Nazarbaev pushed for the country's entry, justifying it by the possibility of greater market access in Russia, a large influx of Russian and Belarusian business thanks to the better business climate in Kazakhstan, larger budget revenues as a result, and better transit routes for Kazakh exports to the EU.¹⁴

3.2. The documents setting up the Customs Union and its common economic space

Vladimir Putin's declarations on integration forced Russian officials to activate negotiations with their partners in Kazakhstan and Belarus. Part of the formal and legal framework for the structures being implemented was based on agreements concluded as part of the Eurasian Economic Community. They served as reference for the documents signed by Russia, Belarus and Kazakhstan on 27 November 2009 and allowed the Customs Union between these countries to be established in 2010. As a consequence, a **single customs tariff** started to apply in the three countries on 1 January 2010 (for the first time since 1991). The **Common Customs Code** became binding on Russia and Kazakhstan on 1 July 2010 and on Belarus on 6 July 2010. An **agreement setting the rules for the distribution of incomes from import duty (as well as taxes and other duties)** between the member states of the Customs Union became effective on 1 September 2010. Furthermore, the Custom Union member states entered into an **agreement regulating the**

¹⁴ Based on: SHUMYLO-TAPIOLA, O. *The Eurasian Customs Union: Friend or Foe of the EU?* Carnegie Endowment for International Peace. 2012. [on-line]. [cit. 2013-12-21] Available from WWW: <http://carnegieendowment.org/2012/10/03/eurasian-customs-union-friend-or-foe-of-eu/dyir#>

operation of the Customs Union within the framework of the multilateral trade system on 19 May 2011. This agreement de facto meant that Russia's obligations with regard to the World Trade Organization (at that time Russia was about to close its accession negotiations¹⁵) would also become binding upon the entire Customs Union.

The customs union was just the first stage in the process of these countries' integration. In 2010, the parties agreed to **form the common economic space** between 1 January 2012 and the end of 2015, and signed seventeen general agreements¹⁶ concerning its operation on 9 December 2010. The three countries' Presidents also signed the following three documents on 18 November 2011 in Moscow:

- an agreement on the Eurasian Economic Commission, setting up a body in charge of integration coordination;
- the Eurasian Economic Commission Regulation;
- and the Declaration on Eurasian Economic Integration which envisaged the creation of the **Eurasian Economic Union** in 2015. This structure was to signify the close politico-economic co-operation between the three states.

The acquits of the integration process initiated by Russia has been supplemented by executive acts and agreements containing more precise regulations in addition to these quite general documents.

3.3. The principles of the EurAsEC Customs Union

As the principles of the Customs Union were being introduced, barriers were also being lifted (with some exceptions, mainly concerning oil trade) in internal trade between these countries within the free trade zone. Furthermore, a **single customs tariff** (SCT) was introduced, which was to a great extent based on that which had previously applied in Russia. 80 % of the common customs rates were the same as the rates used by Russia. According to the Customs Union Commission's estimates, before the SCT was introduced, import duties in terms of the number of items had been 90 % harmonized between Russia

¹⁵ Russia officially joined the WTO on August 22, 2012. Kazakhstan is also in the final stage of its negotiations and hopes to close them in 2014. Belarus's accession process is frozen.

¹⁶ These documents were developed by the Customs Union Commission and ratified at express pace just a few days before the end of 2010. Available from WWW:

http://www.economy.gov.by/ru/f_economic/foreign-policy/foreign-affair-integrity/foreign-affair-integrityformirovanie-edinogo-ekonomicheskogo-prostranstva

and Belarus, but only 38 % between Russia and Kazakhstan¹⁷. It should also be noted that Russian trade policy was less liberal than those adopted by Kazakhstan or Belarus. The weighted average import duty rate in Russia in 2009 stood at 10 %, which meant that the other two member states of the Customs Union had to raise their respective import duty rates. As a consequence of these changes, Kazakhstan's weighted average import duty rate rose from 6,2 % to 10,6 %. In the case of Belarus, the increase in the customs duties was significantly smaller and covered only certain goods, primarily cars, electric engines and leather products. In the next few years, the import duties applicable in the Customs Union were bound to fall, considering Russia's commitments to the World Trade Organization (its weighted average import duty rate should be reduced to 7,8 %). The first changes in the single tariff, with the customs conditions negotiated by Russia taken into account, were made as early as 23 August 2012 (officially joined the WTO). The duty rates were reduced primarily for food (especially pork), clothes, steel products and transport vehicles. In general, the weighted average import duty rate should fall from the previous level of 9,6 % to approximately 7,5 % in 2018.¹⁸

To limit the negative consequences of the SCT introduction (trade diversion and potential loss of competitiveness by local producers), Kazakhstan and Belarus had negotiated a list of goods (over 400 items) which would not be covered by the single tariff in the transitional period¹⁹. For example, until the middle of 2011 citizens of these two countries were allowed to buy cars on the conditions which applied before (a 10 % customs duty rate, while the SCT was 25 %). Kazakhstan and Belarus were also given preferential conditions until 2013 for importing means of transport (railway carriages, including cisterns) and furniture. The Single Customs Tariff did also not apply to medical diagnostic equipment until 2014 and will not apply to pharmaceuticals and aircraft until 2015. At the same time, the duty-free import of aircraft spare parts was not restricted by any timeframe. When the Single Customs Tariff was adjusted to Russia's commitments to the WTO, approximately 120 groups of goods were still excluded from the SCT, for instance cars and pharmaceuticals. Another exception from the SCT was the ten-year

¹⁷ Eurasian Business Council. *Expert opinion of Sergei Glazev, Secretary of the Customs Union Commission*. [on-line]. [cit. 2014-1-8] Available from WWW: <http://www.evrazes-bc.ru/news/view/1132>

¹⁸ According to: SHEPOTYLO, O., TARR, David. *Impact of WTO Accession and the Customs Union on the Bound and Applied Tariff Rates of the Russian Federation*. Trade and Integration Team, Development Research Group, 2012. Policy Research Working Paper 6161. [on-line]. [cit. 2014-1-11]. Available from WWW: <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-6161>

¹⁹ The Eurasian Economic Commission. *Transition duty rates*. [on-line]. [cit. 2014-1-9]. Available from WWW: <http://tsouz.ru/db/ettr/Pages/Perehodny.aspx>

transitional period granted for Kazakh sugar factories, which received consent for duty-free import of raw material for the production of cane sugar. It was also agreed that the import of technological machinery and equipment for investment purposes (used for the modernization of the top priority sectors) would also be exempted from customs duty.

Pursuant to the agreement setting the rules for the distribution of incomes from import duties (taxes and other levies) between the member states of the Customs Union, 87,97 % of the incomes will go to Russian budget, 7,33 % to the budget of Kazakhstan and 4,7 % to the budget of Belarus (ad valorem as a % of the customs value of the goods).

Although the exceptions which are not covered by the single customs tariff form a rather limited number of product groups (120 in 2012 and 400 in 2010, out of a total number of several thousand), they concern products which are important for each given country. Usually, these countries are dependent on imports of such goods, because they manufacture them either not at all or in insufficient quantities. However, a decidedly more important limitation for the common trade policy between the three states is the fact that the single customs tariff does not apply in the case of **export duties**, which are usually imposed on mineral resources – the key export products of these countries²⁰.

Export duty is most frequently used by Russia. It is also worth noting that export duty poses a barrier to internal trade between the three member states of the Customs Union as well. For instance, Moscow imposes it on those crude oil supplies to Belarus which are not intended for the needs of this country. Since 2012, only oil supplied via pipelines to the Customs Union member states is duty-free (customs duty should be imposed on oil transported by railway cisterns). Furthermore, Russia has promised to impose customs duty on all oil sent to Kazakhstan starting from 2014.

The entry into force of the **Common Customs Code** (CCC) in all three member states has been of key significance for the operation of the Customs Union. This document set the same rules for the member states regarding the imposition of customs duty, extra-tariff regulations, customs inspection and all procedures linked to import, export and transport of goods. The CCC was based on the International Convention on the Simplification and Harmonization of Customs Procedures (signed in Kyoto in 1973) and the WTO's requirements. This document introduced facilitations in customs clearance of

²⁰ The share of incomes from sale of mineral resources (oil and petroleum products, natural gas, metal and metal products, and fertilizers) is approximately 80 % of Russian exports, over 85 % in Kazakh exports and less than 65 % in Belarusian exports.

goods supplied from outside the Customs Union, reduced the clearance time and the number of required documents. When the CCC started to apply in internal trade inside the Customs Union, customs clearance was lifted in the case of goods originating from CU member states, or third countries if the goods were cleared by the customs services of any of the CU member states. Furthermore, customs inspection points were withdrawn from the internal borders of the CU. They were liquidated on the Russia/Belarus border on January 1, 2011²¹, and half a year later (on 1 July 2011) on the Kazakhstan/Russia border.

The CCC also introduced a single customs declaration used by all three states, a customs value declaration, and instructions for completing these documents. Since the CCC was being developed at a fast pace, it was impossible to negotiate all the necessary details. As a result, the document includes many references to the national regulations of the countries involved in the integration process. The parties also failed to develop all the necessary executive acts. As a result, differences in some customs procedures used by each of the three states have remained. One example may be the rules of functioning and the procedure for granting Authorized Economic Operator (AEO) status. Such entities had already been present on Belarusian and Kazakh markets, but Russia needed to develop a new law, which was enacted as late as November 2010, and took the form of the Customs Regulations Act (four months after the introduction of the Customs Code).

3.4. The formation of the CU common economic space

Although the Common Economic Space (CES) of the EurAsEC Customs Union formally began to operate on 1 January 2012, most of the executive acts necessary for the structure to meet its assumptions have not yet been agreed on. Work on the required documents and the implementation thereof has been divided into stages according to the schedule for implementing the agreements setting up the CES which was adopted in April 2012. The greater part of the work is expected to have been finalized by 2015, although in some cases the transition periods could even be extended to 2020. Pursuant to the agreements on the CES adopted and the executive acts already developed to some of them, the parties have set the rules of integration in several areas.

²¹ However, according to Belarusian press reports, Russian customs officers returned to the Russian-Belarusian border checkpoint in Smolensk oblast at the beginning of 2012. The Russian side claims that the customs officers are not working at the border checkpoint but only in the customs inspection zone, which is located at the border. For more, see: <http://belaruspartisan.org/economic/215904/>

Economic policy

- **Macroeconomic policy guidelines**, partly by determining the convergence criteria (modelled on the EU's Maastricht criteria): the budget deficit of the CES member states may not exceed 3 % of GDP, the public debt may not be higher than 50 % of GDP, and the inflation rate may not be more than 5 percentage points above the price level in the member state where the inflation is lowest. Officially, these parameters became binding in 2013, although all three countries had already met these conditions in 2011.
- **The operation and access to the services provided by selected natural monopolies**, albeit with the exception of the gas market, which will be regulated under a separate agreement. The parties announced they would adjust their terminology and legislation in order to create the principles for common monopoly regulation, while maintaining the national regulators; and grant entities from the CES non-discriminatory access to the services provided by monopoly firms. The schedule for the step-by-step implementation of common rules regulating the operation of natural monopolies was approved by the Board of Eurasian Economic Commission in February 2013²².
- **Government subsidies for industry and agriculture**: the parties have divided the industrial subsidies into three types: specific (these are admissible, unless they are prejudicial to any partners from the CES), forbidden (the introduction of which enables the partners to use compensation mechanisms) and admissible (horizontal, for instance concerning support for small- and medium-sized businesses or very poor regions). The common criteria for granting the right to subsidies and evaluation of their use will be agreed by 2015. The supranational agency will receive the right to decide whether these can be used by that time, as well. As regards support for agriculture, for example, the parties have agreed that export subsidies will be forbidden, while any support which does not affect trade can be offered without any limitations. The value of subsidies affecting trade has been restricted to 10 % of the net value of agricultural production. The decision on how to report on the subsidies used was passed in November 2011. The participating states thus undertook to adjust their national laws to the community rules (a transitional period until 2016 was

²² Available from WWW: http://www.consultant.ru/document/cons_doc_LAW_156952/?frame=1

introduced for Belarus; it will gradually reduce the value of its subsidies from 16 % in 2011 to the agreed level of 10 %).

- **Public procurement at local level:** it has been agreed that entities from all CES member states will be given equal access, and that the procurement rules, the way information on purchase plans is presented, and the requirements for procurement in electronic form will be harmonized. The parties have agreed that in exceptional situations it will be possible to derogate from these rules for a period not longer than 2 years. National rules began to apply to entities from other CES countries (operation on the same conditions as domestic companies) from 1 January 2014. Among biggest concerns of member states is possible active participation of Chinese companies that through joint ventures in Kazakhstan can create overcompetition at public procurement in the Customs Union²³.
- **The service sale and investment policy rules:** the CES member states have agreed that they will aim to offer their partners access to the services market according to the national rules; the exceptions will be audiovisual services, air transport, banking services, postal services, inland water and maritime transport, and pipeline transport. Foreign investors' share in the telecommunication services and air transport sectors has been restricted to 49 % of the market, and their share in the mass media to 20 %. Nor will the market for lawyer or notary services be subject to integration (those who offer such services must be citizens of a given country). Furthermore, each of the states can also lengthen the list of exceptions individually.
- **The common currency and financial policy:** the parties have promised to harmonize their laws, requirements, market management regulations and the protection of consumer rights on the banking, insurance and securities markets. They have also declared their support for guaranteeing the transparency of their markets' operation. The harmonization was completed by the end of 2013. As regards the common currency policy, the parties have undertaken to coordinate the exchange rate policy and currency repatriation requirements, to introduce standardized terminology, to unify the import and export of currency, to harmonize the standards and rules of currency adjustment, and to coordinate currency control. The regulations for the export and import of currency were unified on 1 July 2010. Furthermore, in

²³ Web portal "Supplychains.ru". [on-line]. [cit. 2014-1-9]. Available from WWW: <http://supplychains.ru/2014/02/12/goszakupki-kazakhstan-ts/>

November 2011, the central banks made arrangements concerning currency policy coordination, and an agreement on the co-operation of agencies in charge of currency audits was signed. Although the documents include no declaration on the introduction of a single currency, Russian side has recently been fostering this idea²⁴ which was consequently opposed by Belarus and Kazakhstan.

- **The rules of intellectual property protection:** the rules being introduced must comply with the international commitments of the states involved in the integration process. The parties have also set general rules for the standardization of copyright, trademarks, names of the places of origin of goods, and patent rights. It is planned to create a common system for the protection of intellectual property rights, and to establish a coordinating authority on the CES level. It was agreed that the acts enabling the use of these rules would be developed by the end of 2012, but this deadline was not met.

Energy and transport policy

These arrangements were to result in free trade in oil and petroleum products, the non-imposition of export duties inside the CES (this rule started to apply when Russia signed bilateral agreements with Belarus and Kazakhstan on settling their accounts regarding the mutual re-export of oil²⁵). Equal nondiscriminatory access to the transport system for entities from all CES member states, common conditions for setting transport tariffs, and the unification of the standards and norms concerning petroleum products have been promised by the parties. A decision of August 2011 imposed the obligation upon the parties to inform each other of the export and import of petroleum products. The parties also agreed on implementation of petrol and diesel oil requirements and standards in 2013²⁶. As regards co-operation in the railway sector, the harmonization of the rules for setting railway tariffs was done in 2013. Unrestricted access to services is to be ensured for entities from all CES member states in 2015. However, the common access and service

²⁴ At the Saint Petersburg economic forum on 15 June 2012, Prime Minister Dmitri Medvedev suggested that a single currency could be introduced in the Eurasian Economic Union. This idea was also backed by the Russian Parliamentary Commission for the CES.

²⁵ For example, the Russian export duty rate is imposed on Russian oil re-exported by Kazakhstan, and is then transferred to the Russian budget. If oil from Kazakhstan is re-exported by Russia, the customs duties go to Kazakhstan's budget.

²⁶ A three-year transition period was introduced in the case of the adopted technical regulation on the requirements concerning petrol and diesel oil, which took effect in 2013. Regulations introducing the Euro-4 and Euro-5 emission reduction standards, which are new in this region, are expected to take effect in Russia and Belarus in January 2015 and in Kazakhstan one year later.

provision rules still needs to be agreed first, originally planned by the end of 2012. The parties' arrangements concerning the gas sector signify that only the procedure for determining the gas price will be established. Access to the transport network is expected to be ensured only upon meeting numerous conditions, or bringing the gas prices on the CES market closer to the free market levels (i.e. a price level comparable to that offered to Europe, minus transport costs and export duty). It is assumed that this will take place in 2015.

The free movement of labor, capital, services and goods

The parties have decided to join efforts to counteract illegal migration of workers from third countries and to determine the legal status of expatriate workers and members of their families. In December 2010, CES member states reached an agreement on the legal status of expatriate workers and on counteracting illegal immigration. Owing to this citizens of the three states can be employed within CES, regardless of their origin, without any restrictions or the need to apply for special permits. The labor market protection mechanisms do not apply to workers from CES. For example, workers from Belarus and Kazakhstan are not included in the quotas of foreigners who can be employed on the basis of a permit.

As a result of the changes which have been taking place within the CES, the process of introducing the **free movement of labor** between Russia, Kazakhstan and Belarus is the most advanced. Even before the present integration structures were created, these countries had offered numerous mutual travel facilitations to their citizens, such as visa-free movement for citizens holding both internal passports (identity cards) and foreign passports. The integration process has also offered citizens of Kazakhstan²⁷ access to the labor market in the CES. At present, citizens of all three countries need not apply for special work permits, and workers from CES member states should be treated as the domestic workforce is. Furthermore, the registration obligation has been lifted from both expatriate workers and members of their families, if their stay is shorter than 30 days.

However, it has been impossible so far to introduce the **free movement of goods**. Although most tariff barriers have been lifted, many other barriers are still restricting trade.

²⁷ The free movement of labor also existed before, as part of the Union State of Russia and Belarus.

The most serious restrictions include the continuing differences in technical requirements and the failure to comply with the agreed rules²⁸.

Progress in introducing the **free movement of capital** has also been rather modest. The main stage of harmonizing laws regulating the banking, currency, securities and insurance markets, including requirements for licensing operation in these sectors, began only by the end of 2013. The entire process is expected to be completed by as late as 2020. It is also likely that further restrictions will be imposed on foreign investors' access to the financial markets in individual CES member states. As part of its negotiations with the WTO, Russia has been given guarantees that the share of foreign capital in the banking and insurance sectors will not exceed 50 %. Belarus also strictly regulates the presence of foreign entities on its market. Only Kazakhstan has no such restrictions; however, its government has begun to consider the possibility of imposing some of them.

Limited progress can also be observed in the introduction of the **free movement of services**. The national regulations of the state in which the service is provided still apply²⁹. The services sector became part of the integration process only within the framework of the CES. Before that, this market segment had been developing autonomously in each of the countries.

However, it turns out that the introduction of the “four freedoms”, especially the free movement of labor and goods, could also have negative consequences for Belarus's plans for developing its local economy. Belarus's government insists that local workforce and goods must be used to the broadest possible extent as part of investment, energy and infrastructural projects. Meanwhile, investors in an increasing number of cases are also including Russian workers and goods in the pool of orders reserved for Belarusian businesses and employees.

²⁸ Epidemiological and sanitary standards which did not fully meet the community requirements still applied in Russia in the first half of 2012. For more, see: <http://www.a4consulting.ru/articles/1728-edinye-sanitarnye-trebovaniya-tamozhennogo-soyuza.html>

²⁹ When the Customs Union was being formed, service sale issues were not raised, and no special regulations in this sector were introduced. The lack of a common policy regarding the services sector in the CU was one of the impediments which prevented Russia, Kazakhstan and Belarus from jointly embarking upon accession negotiations with the World Trade Organization in 2009.

Technical standards

As agreed between the CU's parties at the end of 2010, the community's technical standards³⁰ based on international standards, including those applicable in the WTO and the ISO³¹, should be the only binding standards for these countries as of 1 January 2012 (the national requirements should be lifted). Common sanitary and epidemiological requirements were already adopted for goods subject to this kind of supervision as part of the Customs Union in mid-2010. These standards were also harmonized with Russia's commitments to the WTO. A common list of production types subject to technical regulations was adopted in January 2011. The present version of the list, which was supplemented under a decision by the Eurasian Economic Commission Council of 22 November 2012, consists of 66 items, including machinery and equipment, grain, children's toys and food. In April 2011, the parties further agreed on the procedures to confirm compliance with the requirements. Additionally, agencies from individual countries were put in charge of the technical regulation issues. A register of laboratories authorized to certify goods and admit them to trade in all three countries was also approved at the beginning of 2011. Standardized certificate and declaration registration forms were introduced within the CU in mid-2011. 31 technical regulations (out of the 66 needed) took effect by April 2013.

The effective dates of the remaining ones have been postponed until as late as 1 January 2015³². The regulations which have already been developed cover railway transport safety (in force), food production (as of 1 January 2013), machinery and equipment (as of 15 February 2012) and petrol & diesel oil requirements (1 January 2013), among others. In the case of goods for which common standards have not been developed, the national standards in force hitherto still apply.

3.5. The authorities in charge of operation of the integration structures

It has been agreed that the responsibility for the integration process rests with the newly established authorities of the Customs Union and the Common Economic Space.

³⁰ Exceptions to the community standards could only be made for geographical or climatic reasons. For example, Russia has not decided to impose a ban on using cars with the steering wheel on the right-hand side.

³¹ The International Organization for Standardization.

³² For a complete list of regulations, see: <http://www.tsouz.ru/db/techreglam/Pages/tecnicalreglament.aspx>

Their tasks include administering and supervising the integration process (including monitoring the implementation of the decisions adopted, and developing legal acts to enable deeper integration). It is worth noting that some of these authorities were established after the Eurasian Economic Community had been formed, which raises doubts about the distribution of competences.

The most important political body of the integrating structures is the **Supreme Eurasian Economic Council**, which meets annually at the Presidential level and at least twice a year at the government heads' level. The council meets in the format of five states: Russia, Kazakhstan, Belarus, Kyrgyzstan and Tajikistan. However, decisions regarding the CU and the CES are taken only by the three countries involved in the integration process. The council decides on strategic co-operation directions by consensus. Individual states may appeal to the council if they do not agree with the conditions or methods of integration.

The **Eurasian Economic Commission** (EEC) operating in Moscow is a permanent regulatory body of the Customs Union and the emerging Common Economic Space. This commission replaced the previously operating Customs Union Commission and took over its competences at the beginning of 2012. The EEC consists of the Council and the Board. The council, a political body, is formed by three deputy prime ministers (one from each state), who supervise the Commission's work and decide on the general directions of its operation. The Council of the Commission passes decisions which are within the prerogatives of the EEC (currently predominantly concerning the tariff and customs policy and standardization) by consensus. If the parties are unable to reach the consensus, the issue is passed, to be resolved later by the Supreme Eurasian Economic Commission.

Despite supranational character of the EEC, the decision-making process within the CU and the CES leans towards the intergovernmental model with the member states' governments holding substantial decision-making powers. This is in contrast to the European Economic Commission, which had stronger supranational characteristics. The member states of the CU and the CES participate in the work of the Eurasian Economic Commission, both in the early stages of policy shaping through the consultative bodies of the Commission and in the decision-making process through the Supreme Eurasian Economic Council.

In turn, the **Board** is the Commission's executive body (it has been modelled on the EU's European Commission), and consists of nine members: three representatives

(commissioners) from each state, who are appointed for four years. The Board's tasks include direct management of operation of the bureaucracy of the Customs Union and the Common Economic Space, which is divided into 23 departments. Since 2012, the EEC's competences are primarily as follows: administering and adjusting the tariff & customs policy, developing and supervising compliance with technical, sanitary & phytosanitary regulations, distribution of the income from customs duty, and setting the rules of trade co-operation with third countries (all these functions had previously been performed by the Customs Union Commission). As integration of the three states deepens, the Commission's competences will be gradually expanded, to include for example co-deciding on the anti-trust, currency, macroeconomic, energy and competition policies; regulations concerning government subsidies for industry and agriculture; public procurement, transport and migration. The scope of the Commission's competences will depend on the degree of these states' real integration. The Commission has the right to represent the member states of the Customs Union and to hold international negotiations.

Pursuant to the regulations, the Board passes decisions by a qualified majority of two-thirds of the votes. Each state and the Council of the Commission can contest the Board's decisions at the Supreme Eurasian Economic Commission. Decisions which have been finally accepted by the Commission (the Council and the Board)³³ directly become part of the legal base of the CU and the CES, and do not have to be ratified. The national state authorities are in charge of implementing these decisions.

The number of officials employed by the Commission is constantly growing. One thousand people have been working there since January 2013. 84 % of them are citizens of Russia, 10 % are citizens of Kazakhstan and 6 % are citizens of Belarus. The members of the Commission (both the Council and the Board) have also been granted immunity and federal minister status³⁴. The Commission's budget will be formulated by the states in proportion to their respective shares in incomes from import duties in the CU (Russia accounts for 87,97 %).

³³ To become effective, decisions of the Eurasian Economic Commission must be published on the Commission's website. However, the site was only created on 1 July 2012; before then, decisions were published on the Customs Union Commission's website.

³⁴ The immunity granted can be rescinded by the Commission itself. Other privileges include a 45-day holiday leave, coverage of social, accommodation and medical costs, and wages at ministerial level. The Commission's work will be financed from the budgets of the states involved in the integration process: 87.97% by Russia, 7.33 % by Kazakhstan and 4.7 % by Belarus. In 2011, the Customs Union Commission's budget was worth 437 mio rubles; in 2012, the budget of the Eurasian Economic Commission rose to approximately 4,8 bn rubles.

Officially, the Eurasian Economic Commission was formed on 1 January 2012, but it started *de facto* operation on February 2, 2012, when Viktor Khristenko was appointed head of the Board (so-far deputy prime minister in Russian Federation). The predecessor of the EEC, the Customs Union Commission, finally ceased formal operation as late as 1 July 2012.

The **Court of the Eurasian Economic Community** (operating in Minsk) is in charge of resolving economic disputes and handling the issues of the parties' compliance with the agreements signed. This body has been in operation since January 2012. It consists of ten judges: two representatives of each of the states. Disputes within the Customs Union and the CES are resolved by the judges representing the member states of these organizations. The first instance is formed by a board of three judges; appeals can be addressed to the remaining three judges. The court's verdicts are binding upon the member states.

The establishment of a supranational body, and granting it the competences of making laws which are directly binding upon all the states involved in the integration process, can be recognized as serious achievements by these states. At present this commission effectively administers tariff & customs issues as well as the process of harmonizing the technical requirements. However, on the other hand, the fact that Russian officials predominate in the Commission gives rise to the risk that the integration process will be subordinated exclusively to Russian interests. Furthermore, the Commission's effectiveness has been hampered due to its limited competences and the need to compete with the national ministries and services, which are only reluctantly relinquishing their previous rights.³⁵

3.6. Perspectives of enlarging of the CU

The project of the EurAsEC Customs Union that is supposed to transform into full-value economic union (the Eurasian Economic Union) by 2015 is surely the most ambitious integration project on the CIS space since breakdown of the Soviet Union. It is absolutely clear that the final geopolitical aim of the Eurasian integration lead by Russia is to introduce a strong economic and political player with its borders and interests in both

³⁵ This part is based on: WISNIEWSKA, I. *Eurasian integration: Russia's attempt at the economic unification of the post-soviet area*. Warsaw: Centre for Eastern Studies, 2013. [on-line]. [cit. 2014-1-21] Available from WWW: http://www.osw.waw.pl/sites/default/files/prace_44_eurasian-integration_net.pdf

Asia and Europe and thus create competition to the strengthening influence of China in Central Asia and the EU in Eastern Europe. As it was stated by President of Russia Vladimir Putin in 2013, “his goal is to enlarge the Customs Union to all Post-Soviet states, excluding the three Baltic EU member states”.³⁶

For the moment, the most likely and relevant development of integration process on the post-Soviet space is the expansion of the EurAsEC Customs Union towards Tajikistan and Kyrgyzstan – other Eurasian Economic Community countries, which are not members of the CU yet. Another probable candidate for membership is Armenia which unlike previously mentioned central Asian states has significantly moved ahead since its announcement to join the CU.

Kyrgyzstan

Kyrgyzstan has stated its desire to join the Customs Union when in October 2011, the acting prime minister of Kyrgyzstan announced that his country would join the union, and that the process had been agreed to with the prime ministers of the other member states.³⁷ In the end of 2013 Kyrgyzstan’s Deputy Prime Minister Joomart Otorbaev said a new road map outlining the steps needed to join the union will be prepared by spring 2014. However, later the President Almazbek Atambaev said that Kyrgyzstan will not join the union based on a road map that ignores his country’s interests.³⁸

According to the latest announcement by the Ministry of Economy, the main points of the Roadmap for accession of Kyrgyzstan to the Customs Union had been coordinated. There is only one thing left – to obtain the consent of the Parliament and sign the document. These two final stages promise to be less emotional than a discussion about the future of the Kyrgyz Republic in the CU. Thus, the official entry of Kyrgyzstan to the CU is expected by the end of 2014.

The main supporter of the CU – Kyrgyzian Minister of Economy and Anti-Monopoly Policy Temir Sariyev considers the alliance more in terms of future financial benefits. “*Rapid investments in Kyrgyzstan can only come from Russia and Kazakhstan. Kyrgyzstan will join the Customs Union with regard to the public interest and*

³⁶ News portal “EU observer” [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://euobserver.com/foreign/121304>

³⁷ Autonomous Nonprofit Organization “TV-Novosti”. [on-line]. [cit. 2014-2-26]. Available from WWW:

<http://rt.com/business/customs-union-kyrgyzstan-joins-205/>

³⁸ Radio Free Europe. [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://www.rferl.org/content/armenia-kyrgyzstan-customs-union/25214286.html>

*opportunities of the economy. All are fighting for markets. If we consider the structure of exports, we can understand, where from investments come quick. It is a market of Kazakhstan and Russia. Total exports (excluding gold) go to them. If we want to develop production, we need to develop the market with those whom we trade with,” – he said.*³⁹

Tajikistan

In July 2010, Tadjik President Emomalii Rahmon said: *“What regards our entry into the Customs Union, we deal with this very seriously”*⁴⁰. However, as of April 2014, negotiations on accession to the Customs Union of Tajikistan have not begun. Currently the main obstacle for Tajikistan’ entry to the CU is that it has no common borders with any CU state. Tajik officials said the republic would have to wait until Kyrgyzstan, which shared a border with Kazakhstan, entered into the Customs Union. In turn, Kyrgyzstan expressed the wish for the soonest joining of the organization. *“We are studying how this accession can be to our advantage. If Kyrgyzstan joins, we will be more confident in the validity of joining the union,”* – said the Minister of Foreign Affairs of Tajikistan Khamrokhon Zarifi on May 18, 2012⁴¹.

Tajikistan joined the World Trade Organization in March 2013 and thereby its legislation system is predominantly ready for entering the EurAsEC CU. Russia and Kazakhstan are the two biggest trade partners of Tajikistan, which accounted for 20 % and 13,6 % of Tajikistan’s total foreign trade in January-August 2012.⁴²

Armenia

In December 2012, Armenian President Serzh Sargsyan stated that EU, CIS and Eurasian integration need not be mutually exclusive which, however, was later opposed the EU High Representative of the Union for Foreign Affairs and Security Policy Catherine Ashton.⁴³

³⁹ News Agency “24.kg”. [on-line]. [cit. 2014-2-24]. Available from WWW: <http://www.eng.24.kg/economics/170053-news24.html>

⁴⁰ National Informational Agency of Tajikistan. [on-line]. [cit. 2014-3-23]. Available from WWW: <http://khovar.tj/rus/archive/22830-e.-rahmon-cto-kasaetsya-vstupleniya-v-tamozhenny-oyuz-my-ochen-serezno-etim-zanimaem-sya.html>

⁴¹ News portal “RIA Novosti”. [on-line]. [cit. 2014-3-20]. Available from WWW: <http://ria.ru/politics/20100705/252244680.html>

⁴² Satrapia consortium. [on-line]. [cit. 2014-3-23]. Available from WWW: <http://www.satrapia.com/news/article/tajikistan-expresses-readiness-to-become-customs-union-member/>

⁴³ News portal “Asbarez”. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://asbarez.com/107280/eu-warns-armenia-about-russia-customs-union/>

Although Armenia completed its negotiations with the European Union (EU) about signing Association Agreement in July 2013, on 3 September 2013, President of Armenia Serzh Sargsyan announced in Moscow that Armenia will join the Customs Union of Belarus, Kazakhstan, and Russia. On 2 October 2013, Sargsyan stated at the Parliamentary Assembly of the Council of Europe session that Armenia was ready to sign a deal with the EU during the Eastern Partnership Summit in Vilnius in November 2013, without the Deep and Comprehensive Free Trade Area component of the agreement that contradicts Armenia's membership in the EurAsEC Customs Union.⁴⁴ This proposal was rejected by the EU and no deal was signed between Armenia and the EU at the Summit. As per acting Armenian economy minister Vahram Avanesyan, the formal agreement to formally join the Customs Union of Russia, Kazakhstan and Belarus will be signed at the meeting of the Supreme Eurasian Economic Council at the level of heads of states on April 29, 2014⁴⁵.

Although Armenia's trade with EU states far exceeds that with EurAsEC Customs Union members Russia, Belarus and Kazakhstan combined, Armenia is dependent on Russia for security. Armenia's alliance with Russia is seen by Armenia as a counterbalance to Azerbaijan's sharp hike in military spending (Azerbaijan bought tanks, artillery cannons and rocket launchers worth billions of US dollars from Russia in 2011, 2012 and 2013). This is seen by Armenia as a threat given that the Nagorno-Karabakh War (an armed conflict that took place from 1991 to May 1994 de-facto between Armenia and Azerbaijan) remains unresolved. Russia also has a military base in Armenia.⁴⁶

Other states

The accession of other countries that previously expressed willingness to join the CU – Moldova, Georgia and Ukraine – is now either practically impossible or under big question. The reason is their choice to sign the European Union Association Agreement that supposes free-trade area between the EU and signing countries as well as cooperation and convergence in policy, legislation and regulation across a broad range of areas,

⁴⁴ News portal "ArmeniaNow.com". [on-line]. [cit. 2014-2-23]. Available from WWW:

http://armenianow.com/news/48880/armenia_president_serzh_sargsyan_strasbourg_pace_speech

⁴⁵ News portal "PanARMENIAN.Net". [on-line]. [cit. 2014-2-23]. Available from WWW:

http://armenianow.com/news/48880/armenia_president_serzh_sargsyan_strasbourg_pace_speechhttp://www.panarmenian.net/eng/news/178088/Armenia_to_sign_Customs_Union_accession_deal_April_29

⁴⁶ Institute for War & Peace Reporting. [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://iwpr.net/report-news/armenias-receding-european-ambitions>

including equal rights for workers, steps towards visa-free movement of people, the exchange of information and staff in the area of justice etc.

Thus, Georgia and Moldova that previously revealed the possibility of their entry to the Customs Union will finally sign up the Association agreement with the EU by June 2014. It was announced on the EU summit in Brussels on March 21, 2014. Before leaders of the EU's 28 member states hoped to sign the agreements by the end of September 2014. The latest change of timeline is a response to Russia's annexation of Crimea, which has caused alarm in Moldova and Georgia, both of which saw regions break away from central control in the early 1990s. The Georgian regions of Abkhazia and South Ossetia and the Moldovan region of Transnistria have operated as *de facto* Russian protectorates ever since.⁴⁷

During the same summit of the EU that took place in March 2014 a political part of the Association Agreement between Ukraine and the EU was signed. The deal commits Ukraine and the EU to closer political and economic cooperation and unilaterally opens EU market for Ukrainian goods for tariff-free trade. More substantial parts of the agreement regarding economic and trade cooperation will be signed after Ukraine has held new Presidential elections in May 2014.

The other 3 post-Soviet republics – Azerbaijan, Turkmenistan and Uzbekistan – prefer to stay away from any close regional economic integration within the CIS space. It's worth mentioning that all of these countries share some similar features. Firstly, all of them are situated in the Caspian Sea region and hold significant reserves of oil and natural gas, thus being big net exporters of these resources and creating only westward route for central Asian oil and gas that bypasses Russia. Secondly, according to the Freedom House Map of Freedom 2013⁴⁸, all three countries are included in the list of "Not Free countries"⁴⁹ and the peculiarity of their political system is that the power has been kept by their political elites since the breakdown of the Soviet Union. Due to substantial mineral reserves those regimes are economically sufficient and relatively independent in their trade policies and hence are not forced to conduct crucial economic or political reforms. Thirdly, all these countries are inclined for independent foreign policy and tend not to join any regional

⁴⁷ Newspaper "European Advice". [on-line]. [cit. 2014-2-11]. Available from WWW:

<http://www.europeanvoice.com/article/2014/march/eu-brings-forward-moldova-georgia-deals/80179.aspx>

⁴⁸ Available from WWW:

<http://www.freedomhouse.org/sites/default/files/Map%20of%20Freedom%202013%2C%20final.pdf>

⁴⁹ Freedom House: "A Not Free country is one where basic political rights are absent, and basic civil liberties are widely and systematically denied."

integration, primarily being afraid of strengthening of Russian influence and efforts to restore its political and economic hegemony in the region. Thus, Azerbaijan, along with Uzbekistan and Turkmenistan, did not join the Treaty on the CIS Free Trade Area, signed on October 18, 2011 by the heads of governments of eight other Commonwealth member-states. At the same time 2 of these states – Azerbaijan and Uzbekistan – together with Moldova, Georgia and Ukraine were members of the GUUAM treaty, a strategic alliance aimed primarily at military, economic and political cooperation, bound by a desire to resist the perceived threat of Russian expansionism in the region.

Free trade agreements

Even though the CU virtually exists only 4 years, it managed to sign important free-trade agreements with several states and economic blocs. There are free-trade agreements between the CU and CIS countries (except Uzbekistan, Turkmenistan and Azerbaijan) since 2011 and with Serbia (bilateral agreements with CU member states were signed during 2000s). In 2014 it is planned to sign a free-trade agreement with New Zealand and the European Free Trade Association (Norway, Iceland, Switzerland, and Liechtenstein). At the same time the Eurasian Economic Commission and the CU countries are currently conducting consultations and negotiations with other 30 countries and trade organizations on issues related with the possibility to sign free trade agreements and intensify mutual economic cooperation. Among those are: Vietnam, Israel, Montenegro, Syria, Vietnam, India, Iran, Turkey etc.⁵⁰

⁵⁰ News portal “Rossiyskaya gazeta”. [on-line]. [cit. 2014-2-10]. Available from WWW: <http://www.rg.ru/2014/02/04/zona.html>

4. Belarus' economy and foreign trade

This part aims to describe the main features of economic development of independent Belarus. While it gives a brief historic insight into the hallmarks of Belarus' economic development the main focus is concentrated on the analysis of recent economic performance. The analyzed time horizon covers a period since 2008 till and 2013 and together with major macroeconomic indicators (GDP, inflation and unemployment rates, growth of real income by population etc.) pays specific attention to the description of structure of Belarus' foreign trade in goods with its major economic partners (the CU, the EU and Ukraine).

4.1. Belarusian economy after getting independence

Since getting its independence in 1991, Belarus has faced similar problems like other CIS states, i.e., transition from a centrally planned to a market economy. President Lukashenka in 1995 put the country on the path of “market socialism” and in accordance with this policy tried to retain control over commodity prices and the exchange rate of Belarusian ruble and strengthen administrative supervision of business activity. A country is endowed with a relatively high standard of living and advantageous geographic position between Russian and Eastern European markets and had all assumptions to start its rapid economic development after the collapse of the USSR. However, instead of this it continuously adheres to the failing central control of the economy, while neighboring countries already stood on the path of market economy.

During the operation of the Soviet Union Belarus was marked as a solid industrial base and was even considered as a kind of “assembly plant” around Union. Despite weakening in this area it is still possible to speak about industrial complex dominated by mechanical engineering, heavy manufacturing, chemical and petrochemical industries, and production of textile, glass and food. The petrochemical industry is concentrated mainly on the processing of oil, which is imported from Russia. The oil that is extracted on the territory of Belarus, covers about 10 % of domestic consumption. The engineering industry is dominated mainly by manufacturing, buses, trucks, trolleybuses and tractors.

Agriculture remains the weakest link in the national economy, despite substantial funding from the state budget in the form of various types of subsidies and tax credits. The main reason is the loss of former customer-supplier relationships, which occurred after the

collapse of the USSR, worn agricultural machinery and active urbanization. Belarus is among the seven largest producers of potatoes in the world, while in its production per capita occupies the first place. In flax fiber production Belarus is among the five largest producers in the world.

On the territory of Belarus is concentrated more than 4000 mineral resources, while about 30 different species belong to the industrial minerals. The most important include potassium salt, oil, brown coal, or oil shale. In the case of potassium salt Belarus has the biggest bearings in Europe.

Place and role of Belarus in the system of world economic relations are also determined by its transit position – through its territory pass basic transport arteries linking the industrialized west and rich in natural resources east, including major pipeline transport facilities, such as pipeline “Yamal-Europe” or pipeline “Druzhba”. By the volume of international transportation through the territory Belarus holds stable fourth place in Europe.

GDP growth in the years 1999-2002 in the wake of the financial crisis of Russia slightly slowed down. This period was followed by impressive enhance of economic growth and living standards in the years 2003-2007 which coincided with an average growth of GDP of more than 9 %. The most important factors for economic growth were significant improvement in the sphere of trade and better relations with major economic partners. During this period, household consumption grew by an average of more than 12 % per annum, leading to a reduction of poverty from 30,5 % of the population in 2002 to 7,7 % in 2007⁵¹.

Despite having planned economy with a system of so-called “five-year plans” Belarus has been for many years reporting favorable economic figures. Anyway despite its seeming success there is a number of cracks that limit its flexibility and competitiveness in particular, and make it particularly vulnerable to external influence. Specifically it concerns high dependency on energy supplies from Russia, inflexible exchange rate and limited role of the private sector. That happened in 2009 when Belarus was highly effected by economic recession of it major economic partner – Russia. Economic slump of 2009 was discharged by vast fiscal inputs in the economy next years.

⁵¹ According to the data from the World Bank.

In 2011 a financial crisis began, triggered by government directed salary hikes unsupported by commensurate productivity increases. The crisis was compounded by an increased cost in Russian energy inputs and an overvalued Belarusian ruble, and eventually led to a near three-fold devaluation of Belarusian ruble in 2011. In November 2011, Belarus agreed to sell to Russia its remaining shares in Beltransgaz, Belarusian natural gas pipeline operator, in exchange for reduced prices for Russian natural gas. Receiving more than USD 2,5bn of loans and about USD 2,5bn from sale of Beltransgaz helped stabilize the situation in 2012; nevertheless, Belarusian currency lost more than 60 % of its value, as the rate of inflation reached new highs in 2011 and 2012, before calming in 2013. As of January 2014, the final tranche of the EurAsEC loan has been delayed, but in December 2013 Russia announced a new loan for Belarus of up to USD 2bn for 2014. Notwithstanding foreign assistance, Belarusian economy continues to struggle under the weight of high external debt servicing payments, a growing trade deficit, stagnant economic growth, and low foreign reserves.⁵²

Table 2 shows the development of some basic macroeconomic indicators for years 2008-2013.

Table 2: Belarus' major macroeconomic indicators in 2008-2013

Year	2008	2009	2010	2011	2012	2013
GDP (current bn USD) ⁵³	60,8	49,2	55,2	64,2	63,3	63,9
GDP growth (%)	34,5	-19,1	12,2	16,3	-1,4	0,9
The growth rate of industrial production (%)	11,5	-2,8	12,0	9,3	6,2	-5,1
The growth rate of agricultural production (%)	8,6	1,3	3,1	7,4	6,0	-4,2
The growth rate of retail sales (%)	19,7	3,5	15,7	9,0	14,1	-
Inflation by CPI (%)	13,3	10,1	9,9	108,7	21,8	16,5
The growth rate of real income by population (%)	11,8	3,7	14,8	-1,1	21,5	-
Unemployment rate (%)	0,8	0,9	0,7	0,6	0,5	-

Source: National Statistical Committee of the Republic of Belarus, the World Bank.

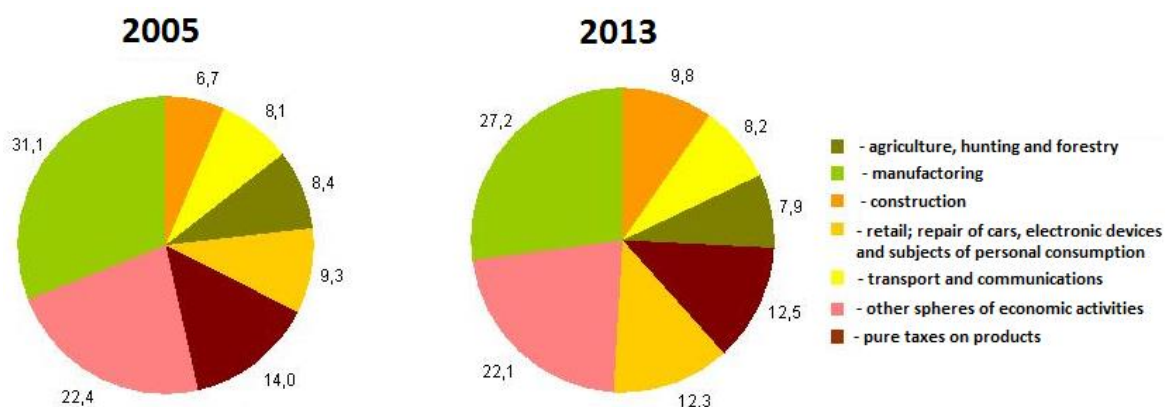
Statistics show strong growth of Belarusian GDP in 2000s (including 10,2 % growth in 2008), that almost came to a stop in 2009. Externalities and price shocks in conjunction with the international economic and financial crisis uncovered vulnerabilities of Belarusian economic model and pushed the country back into recession. As a reaction to Russia's 26,3% GDP decline, Belarus' product plunged by 19,1 % in 2009. Impacts of the crisis on major trading partners, especially Russia, led to negative trends in the field of

⁵² CIA. [on-line]. [cit. 2014-2-23]. Available from WWW: <https://www.cia.gov/library/publications/the-world-factbook/geos/bo.html>

⁵³ According to the World Bank.

Belarusian export production. Compared to 2008, there was a decline in industrial production by 2,8 %. There has been a slowdown in agricultural production and also significant slowdown of retail sales growth. Years 2010-2011 were the period which concurred with extensive anti-crisis financial inflows made by the government in order to revitalize the economy and significant foreign trade growth, especially with CU partners. Despite the obstacles of centrally planned economy and high inflation it was defined by significant increase in almost all macroeconomic indicators that consequently help reach almost all of pre-crisis figures by the end of 2011.

Graph 1: Structure of Belarus' GDP by sector in 2005 and 2013 (%)



Source: National Statistical Committee of the Republic of Belarus.

What concerns the structures of Belarus' GDP (see Graph 1), the most important sectors in 2013 were manufacturing – 27,2 %, retail and repair – 12,3 %, construction – 9,8 %, transport and communications – 8,2 %. The sphere of agriculture had insignificant share of GDP of 7,9 %, even though it employs about 10 % of all labor force. This sector is predominantly state-owned and even in spite of big investments and subsidies from the government remains constantly unprofitable. In general, during last 5 years the structure of GDP experienced these changes: the share of agriculture and manufacturing declined while spheres of retail, construction and transport grew accordingly.

Throughout the 2000s, as a reflection of vivid macroeconomic growth, real wages in Belarus were increasing and by the presidential elections of 2010 reached the equivalent of 500 USD. Nevertheless, in 2011 the country faced drastic financial crisis, which resulted in 54 % devaluation of Belarusian ruble in May 2011 and had an effect on sharp fall in standard of living of population. As a result, average nominal wages decreased from 500 USD to 312 USD by May 2011 and to 218 USD by September 2011. Subsequently, wages

began to rise again and reached equivalent of 430 USD in 2012 and 521 USD by February 2013 in nominal prices.⁵⁴

During all 2000s the rate of inflation in Belarus has been continuously decreasing and reached 9,9 % in 2010. However, continuous overvaluation of Belarusian ruble led to vast financial crisis in 2011, followed by enormous devaluation and 108,7% rise of inflation in the same year. Later the price level stabilized around 21 % in 2012 though by official forecasts it should have not exceeded 12 %. Since 2010, Belarus is one of the world leaders in terms of inflation, leaving behind all the countries of Europe and Asia. According to the Ministry of Statistics of Belarus, the consumer price index for goods and services in 2013 increased by 16,5 % compared to 2012 (prices of food products grew by 18,8 % , manufactured goods – by 7,2 %, services – by 38 %). According to the official forecast, the inflation in 2014 will be about 11 % but this figure is doubted by majority of independent experts including the World Bank, the IMF and even the Ministry of Economic Development of Russia⁵⁵.

According to official statistics (see Table 2 before), Belarus' unemployment rate has not exceed 1 % in the last 6 years. At the same time these positive figures do not logically correspond to other macroeconomic indicators in the same period, thus we should search for more logical explanation of this phenomenon. The answer is simple: unemployment statistics in Belarus do not comply with worldwide standards of the International Labor Organization, even though the country has been its member since 1954. Instead of calculating unemployment by the ILO methods, the indicator is equated with the number of people registered at the State Employment Service. It is believed that the low number of officially registered unemployed people is due to the very low level of unemployment benefits (15-20 USD/month) and commitments to participate in public works even though they are officially prohibited by the Convention of the ILO. The real unemployment rate may be much higher. Nevertheless official unemployment rate for 2013 was only 0,5 %, some analysts suppose that the real figure is about 40 times higher

⁵⁴ Mojazarplata.by (part of Wageindicator Foundation). [on-line]. [cit. 2014-3-23]. Available from WWW: http://mojazarplata.by/main/minimalka/min_zarplata/uvelichenie-minimalnoj-zarplaty

⁵⁵ Informational agency "REGNUM". [on-line]. [cit. 2014-2-23]. Available from WWW: <http://regnum.ru/news/fd-abroad/1779859.html>

and may increase to 30 % by the end of 2014 due to massive outflow of qualified labor to Russia because of the ongoing crisis⁵⁶.

As per analyzed data, we can generally say that Belarus' entry to the CU did not have real positive influence on the development of its major macroeconomic indicators. In the period of 2008-2013 the real GDP grew only by 4,1 % (see the Table 2 before). This modest figure can be basically explained by overall stagnation and slowdown of Belarus' economy during and after global economic crisis when it firstly lost 19,1 % of its production in 2009 and then started quick recovering with 12,2 % and 16,3 % GDP growth in years 2010 and 2011 accordingly. Same situation happened after the financial crisis of 2011 when the GDP declined by 1,4 % in 2012 and modestly grew by 0,9 % by the end of 2013. Sad situation around Belarus' GDP growth was accompanied by substantial decrease in its industrial and agricultural production coincided with sharp growth of stocks of finished goods in warehouses.

One of the main reasons for this fact was stagnation on the main partners' markets – Russian and Kazakh (for more, see 6.4. Economic overdependence from Russia). For Belarus' export-oriented economy it means continuing stagnation and waiting for the rise of consumer demand abroad. This conclusion is also corroborated by the World Bank forecasts that suppose that Belarus' GDP growth in following years will be insignificant and will total 1,5 % in 2014, 2,0 % in 2015 and 2,5 % in 2016⁵⁷.

As we can also see, the appliance of a SCT narrowed the breadth of Belarus' foreign trade (for more, see 6.2. Narrowing of the breadth of Belarusian foreign trade) and consequently made Belarusian exports even more dependent on the situation on external markets then it was before. As an evidence could serve the fact that in November 2011 international rating agency Standard & Poor's transferred Belarus and its banking sector in the group of countries with the greatest economic risks (along with Greece and Vietnam) by giving it the lowest mark. *"In accordance with our criteria for evaluation of economic risk "10" reflects our view that the country is subjected to extremely high risk of economic imbalances, exceptionally high credit risk in the economy and a very high risk of violations of economic stability,"* – was said in a press release. Agency experts also believe that

⁵⁶ Agency of Financial News (AFN). [on-line]. [cit. 2014-2-23]. Available from WWW: <http://afn.by/news/i/169226>

⁵⁷ The World Bank. [on-line]. [cit. 2014-2-22]. Available from WWW: <http://data.worldbank.org/country/belarus>

*economic growth in Belarus is relatively unstable, inflation – high and the economy is heavily dependent on external demand and commodity prices.*⁵⁸

4.2. Belarus' foreign trade policy

Before the beginning of this part that is aimed to statistically describe the state of Belarus' foreign trade before and after it joined the CU we should sincerely admit that unfortunately it will be almost impossible to quantify impacts of this accession in the conventional sense due to several reasons.

Firstly, Belarus' foreign trade with other CU members functioned without customs duties and major quantitative limitations even before formation of the union due to previously signed bilateral trade agreements (in 1992 with Russia and in 1997 with Kazakhstan).

Secondly, it is very difficult to determine the date of the actual beginning of launch of the CU which would be correct to start our assessment of economic consequences. Formally, the countdown began on January 1, 2010 when the Single Customs Tariff (SCT) came into force. However, the introduction of the Common Customs Code (CCC) was held only in July 1, 2010, and the termination of customs authorities on the union's internal borders was made only by July 1, 2011. Thus, conditionally allocated "pure" period within which is possible to analyze the positive effects of Belarus' participation in the Customs Union is limited to about 2,5 years (from 1 July, 2011 till the end of 2013. However, for the sphere of foreign trade this period is too short, because the adjustment of trade flows occurs with significant delay, taking into account the terms of foreign trade contracts, time spent on marketing and so on.

Thirdly, due to Russia's WTO accession in August 2012 the terms of trade for Belarus has changed substantially. According to the "Treaty on the functioning of the Customs Union within the multilateral trading system"⁵⁹, the CU SCT rate has been adjusted taking into consideration tariff commitments of Russia to the WTO. The resulting effects are of independent meaning (given that Belarus remains outside the WTO), and therefore the estimation of the "pure" effects of the CU on the foreign trade of Belarus after this event does not seem correct.

⁵⁸ Agency of Financial News (AFN). [on-line]. [cit. 2014-2-23]. Available from WWW: <http://afn.by/news/i/159688>

⁵⁹ Available from WWW: <http://sudevrazes.org/main.aspx?guid=19441>

Fourth, it is too early to talk about full-fledged functioning of the Customs Union because there are still many barriers and constraints in mutual trade. On a wide number of products, for example, participating countries use their own import duties that are different from the SCT rates.

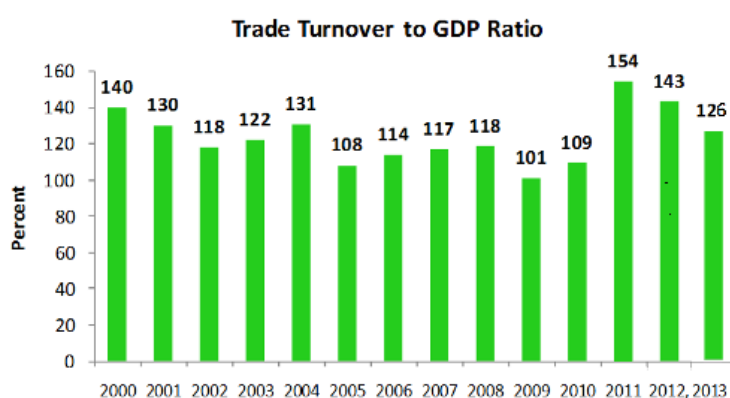
Due to all mentioned factors this paper will take into account the general trend of development of Belarus' macroeconomic and especially foreign trade indicators and will analyze the reasons (political and economic) that could cause their alteration. On basis of Belarus' recent economic performance and situation in the economies of Belarus' major economic partners we will try to characterize the perspectives of its further participation on the aforesaid economic integration.

4.3. General structure of Belarus' foreign trade

Belarus counts under small open economies meaning it can hardly influence prices or interest rates in the global markets. As an open economy the country depends on its outward connections what led to the fact that its foreign trade turnover has historically been larger than the GDP. Moreover, Belarus ranked 19th out of 140 countries surveyed by DHL in terms of its dependence on foreign trade in 2011⁶⁰. Like other small emerging economies, Belarus is highly volatile, with a consequence that key economic variables change significantly over time: it is evident from Graph 2 which shows that despite continuously growing GDP, there were significant ups and downs in Belarusian foreign trade development.

⁶⁰ The latest report released: DHL. [on-line]. [cit. 2014-2-23]. Available from WWW: http://www.dhl.com/content/dam/flash/g0/gci_2012/download/BLR.pdf

Graph 2: Ratio of Belarus' trade turnover to its GDP, 2000-2013



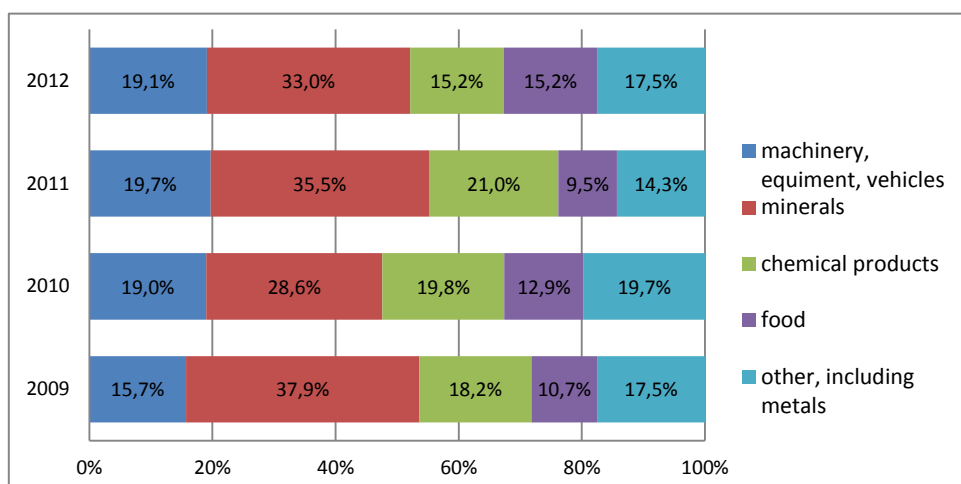
Source: Source: Belarus Project. [on-line]. [cit. 2014-2-23]. Available from WWW: http://belarus-project.eu/2013/01/belarusian_foreign_trade/#_ftn2

Exports

Despite its small size and small portion of exports on the global scale (0,24 % in 2013), Belarus holds leading positions in the world in potash fertilizers and mining dump trucks with 43 % and 33 % of the global market share respectively.

Minerals constitute the largest portion of exports (see in fig. 2), mainly presented by fuels and petrochemical products refined from Russian oil. Two state-owned oil-refining plants (in Navapolack and Mazyr) manufacture a range of fuels and distillation products which are then exported via BelOil Company. Fuel products represent the biggest part of exports, e.g. they make up about half of the EU imports from Belarus.

Graph 3: Commodity structure of Belarusian exports, 2013



Source: National Statistical Committee of the Republic of Belarus.

The second largest position of Belarusian exports is machinery (mining dump trucks, other agricultural machinery, motor vehicles, refrigerators etc.). This is the result of the broad industrial base of heavy machinery established back in the Soviet era. The main consumers of this exports group are Russia and other former Soviet countries.

The third most important export group is chemicals where potash fertilizers take the biggest part followed by nitrogenous fertilizers. Belarus rates among the three largest producers and exporters of potash worldwide, the other two being Canada and Russia. In order to promote exports of potash fertilizers, Belarusian Potash Company was established in 2005. Today it exports potash fertilizers to 80 countries in the world and has a global share of exports of 43 %.

The structure of exports remained relatively stable over years excluding share of exported minerals that fluctuated regarding politically inclined agreements with Russia. As we can see, the share of exported minerals (mostly fuels produced from Russian subsidized oil and re-exported natural gas and oil) declined by almost 10 % from 2009 to 2010 as a result of Belarus' enter to the Customs Union. According to the CCC the member country that purchases mineral resources in other CU country had to pay 30 % export duties in case the resources are re-exported directly or after refining to any non-CU state. Basically speaking, this step significantly limited the profits that were supporting so-called "Belarusian economic miracle" in the 2000s⁶¹.

⁶¹ For more, see: News portal "Telegraf". [on-line]. [cit. 2014-2-27]. Available from WWW: <http://telegraf.by/2014/03/investicii-i-vneshnii-dolg-belarusi>

If we look at Belarus' most important trade partners by export value, then the statistics for 2013 were following ⁶²(mio USD):

Table 3: Belarus' most important trade partners by export value (mio USD)

Year	2012	2013	% change
Russia	14 509	16 829	16 %
Netherlands	7 551	3 343	-56 %
Ukraine	4 195	4 160	-1 %
Latvia	3 270	529	-84 %
Germany	1 737	1 754	1 %
Lithuania	1 181	1 077	-9 %
Poland	949	782	-18 %
Brazil	802	519	-35 %
Italy	677	903	33 %
Kazakhstan	674	868	29 %

Source: National Statistical Committee of the Republic of Belarus.

As usually, the absolute leader in Belarus' exports in 2013 was Russia that bought 16 % more goods by value than in previous year. The second position was occupied by Ukraine that distanced the Netherlands. The latter together with some other countries (e.g. Germany, Latvia, Brazil and Poland) experienced dramatic drop in the value of Belarusian imports caused mainly by the decrease in the volumes of exported fuels and petroleum products due to scandal with non-payment of export duties to Russia (for more information, see 6.3. Narrowing of the breadth of Belarusian foreign trade

Foreign trade is vital for Belarus' economy and traditionally generates about half of its GDP. Despite substantial world market shares in some products like potash fertilizers or mining dump trucks, Belarusian trade has very strong regional focus. USSR heritage results in developed heavy machinery industry, but also in very high dependence on imports, especially minerals necessary for development of its machinery and petrochemical industries. It can be seen, e.g., from traditionally high percentage (50-60 %) of imports from Russia which are mostly minerals. This aspect is one of the reasons why Belarus' has traditionally had low characteristics of breadth of trade. Thus, according to DHL Global Connectedness Index, Belarus has one of the most regionally concentrated trade structures in the world which resulted in its 117th position out of 140 countries in breadth of trade in 2011. The figure indicates strong focus of Belarus' foreign trade on limited number of countries and critically narrow breadth of its trade connections. Picture 5 illustrates the destinations of Belarusian exports (countries are sized in proportion of their share in Belarus' exports and are colored in proportion of Belarus' share in their imports).

⁶² National Statistical Committee of the Republic of Belarus. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://belstat.gov.by/homep/ru/indicators/ftrade1.php>

Picture 13: Belarus' merchandise exports, 2011

Source: DHL Global Connectedness Index. [on-line]. [cit. 2014-3-23]. Available from WWW:

<http://www.dhl.com/content/dam/flash/g0/gci/download/BLR.pdf>

The process of narrowing the breadth of Belarus' foreign trade is not only a matter of nowadays but has already had place at least for last decade and intensified after Belarus entered the Customs Union in 2010. According to the data from the DHL Global Connectedness Index, since 2005 Belarus has come down by 13 positions in breadth of foreign trade and occupied 117th place among 140 observed countries in 2011. The share of trade on the same continent in 2011 amounted to 85 % while in 2005 it was only 35 %. Thereof, we can notice that Belarus' foreign trade policy is continuously inclining towards concentration on Eurasian post-Soviet markets (especially Russian) at the expense of other countries. From this reorientation especially suffers trade with the EU – the market that until 2013 unlike other trade partners had generated positive trade balance for Belarus. As could be clearly seen before from Table 19 the share of Belarus' exports to the EU has been continuously falling from 29,5 % in 2008 to 21,0 % in 2012. The same tendency is observed by imports from the EU. It finally led to the shrinkage of the EU-Belarus turnover for more than 7 % during 4 years since 2008. At the same time the importance of Russian market for Belarussian goods has been growing steadily. Thus, Russian share in Belarussian exports increased for about 13 % from 2008 till 2013 while Russia steadily maintained about half of Belarus turnover since Belarus got its independence in 1990. It is a clear sign of Belarus' continuous trade dependence on Russia and regime's politic and economic narrow-mindedness. Instead of trade diversification, the government has been continuously intensifying economic relations with its eastern partners that concluded with Belarus' entrance to the Customs Union (for more, see **Chyba! Nenalezen zdroj odkazu.**2. Effects of the CU on Belarus' foreign trade flows).

Table 19: Shares of Belarus' partners in it foreign trade turnover (% of total)

Year	2008	2009	2010	2011	2012	2013
With Russia	47,3	47,0	46,6	45,2	47,4	49,5
- Exports	32,4	31,5	39,4	35,0	35,4	45,2
- Imports	59,7	58,5	51,8	54,5	59,4	53,2
With Kazakhstan	0,7	0,8	1,4	0,9	1,0	1,2
- Exports	1,1	1,5	1,8	1,6	1,8	2,3
- Imports	0,4	0,3	1,2	0,3	0,3	0,2
With other countries of the CIS	8,0	7,4	8,8	9,4	9,8	9,4
- Exports	10,6	10,7	12,7	12,5 %	14,3	14,3
- Imports	5,8	5,0	5,9	6,6	5,3	5,2
With the EU	23,1	20,6	19,6	17,7	16,5	-
- Exports	29,5	31,7	33,4	23,3	21,0	-

- Imports	17,8	12,3	9,6	12,6	12,1	-
With the rest of the world	20,9	24,2	23,6	26,7	25,2	-
- Exports	26,4	24,6	12,7	27,5	27,5	-
- Imports	16,3	23,9	31,5	26,0	22,9	-

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

Dependence on oil-processing industry).

Imports

Although exports are a big part of Belarusian foreign trade, the country has historically had negative trading balance as imports exceeded exports (see Graph 4). The balance of payments, therefore, was partly balanced by positive balance of foreign trade in services and foreign investment inflows but mainly by growing foreign debt which has increased by 22 times from 589 mio USD at the beginning of 2007 to 13 006 mio USD at the beginning of 2012⁶³.

Graph 4: Belarus' trade balance, 1995-2013



Source: Belarus Project. [on-line]. [cit. 2014-2-23]. Available from WWW: http://belarus-project.eu/2013/01/belarusian_foreign_trade/#_ftn2

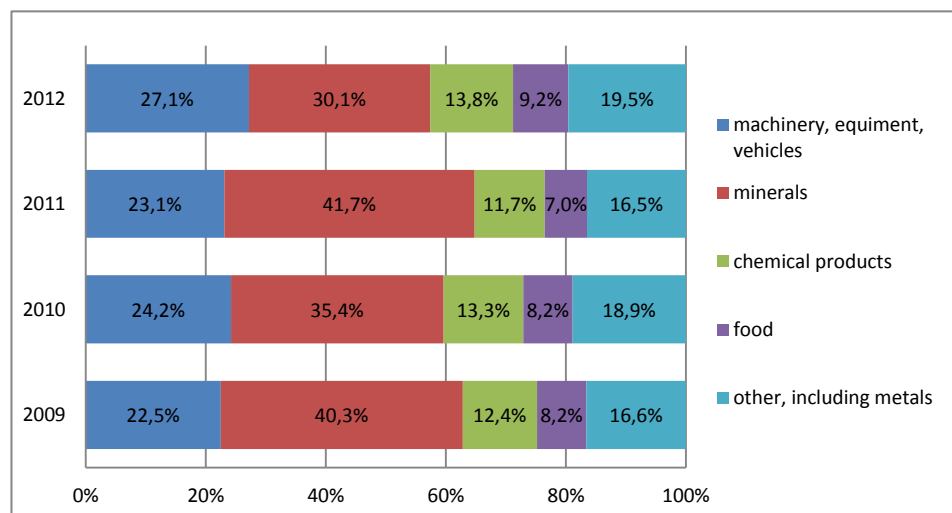
Belarus is largely dependent on natural gas and crude oil imports mainly from Russia which accounts for approx. 40 % of its imports (see Graph 4). In fact, Belarus used to be a leading consumer of Russian gas per capita in the world. Gas is used exclusively for domestic consumption: over 70 % of it goes to production of electricity and heating. Belarus enjoys preferential pricing for gas due to intergovernmental arrangements and membership in the EurAsEC Customs Union.

The second largest import position holds machinery, geographically dominated by CIS countries that used to be parts of former Soviet interstate supply chain network.

⁶³ According to the National Bank of Belarus.

Belarus mainly imports components for its machinery production, e.g. parts of transportation vehicles, machines and mechanical appliances whereas investment goods constitute only a small share of Belarusian machinery and equipment imports.

Graph 5: Commodity structure of Belarusian import



Source: National Statistical Committee of the Republic of Belarus. Own calculations.

Within other groups a particular share belongs to metals. They include both ferrous and non-ferrous metals and are used as supply materials for Belarusian steel works. The commodity structure of imports is presented.

Belarusian import dependence (share of import to GDP) is among the highest in the world (15th in 2010 and 5th in 2011) according to DHL Global Connectedness Index.⁶⁴

If we look at Belarus' most important trade partners by import value, then the statistics for 2013 are following⁶⁵ (mio USD):

Table 4: Belarus' most important trade partners by import value

Year	2012	2013	% change
Russia	27 551	22 888	-17 %
Germany	2 732	3 035	11 %
China	2 373	2 829	19 %
Ukraine	2 309	2 057	-11 %
Poland	1 349	1 589	18 %
Italy	956	1 108	16 %
USA	634	587	-7 %
Netherlands	448	444	-1 %
Czech republic	441	496	12 %
France	436	496	14 %

Source: National Statistical Committee of the Republic of Belarus.

⁶⁴ DHL Global Connectedness Index. [on-line]. [cit. 2014-2-23]. Available from WWW:

http://www.dhl.com/content/dam/flash/g0/gci_2012/download/dhl_gci_2012_complete_study.pdf

⁶⁵ National Statistical Committee of the Republic of Belarus. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://belstat.gov.by/homep/ru/indicators/trade1.php>

As we can see, as in case of exports the main import partner of Belarus in 2013 was Russia that significantly outstripped Germany and China that occupied second and the third positions accordingly.

4.4. Belarus' foreign trade inside the CU

Russia and Kazakhstan have always played a key role in Belarus' foreign trade relations, especially for its exports part. Their prior role has even deepened after entering the EuraAsEc Customs Union and applying common trade policy and SCT in particular. This way their markets appeared to be even more interconnected and interdependent. In 2013 these countries generated more than half of Belarus' total foreign trade turnover and accounted to 48 % of its all exports and 53 % of imports.

Belarus-Russia

As we could see from the previous paragraph, Russia has traditionally been a main trade partner of Belarus and, moreover, its status is even increasing. Thus, when cooperation between two countries in 2008 amounted to 47,3 % of Belarus' total trade turnover, in 2013 this share was already 49,5 % (see Table 5).

Table 5: Foreign trade between Belarus and Russia

Total value (mio USD)						
Year	2008	2009	2010	2011	2012	2013
Turnover (all countries)	71 952	49 873	60 168	87 178	92 464	80 231
Turnover (Russia)	34 059	23 445	28 034	39 439	43 860	39 717
- Exports	10 552	6 719	9 954	14 509	16 309	16 829
- Imports	23 507	16 726	18 081	24 930	27 551	22 888
Balance	-12 956	-10 008	-8 127	-10 422	-11 242	-6 058
Relative change (% of previous year)						
Year	2008	2009	2010	2011	2012	2013
Turnover (all countries)	136	69	121	145	106	87
Turnover (Russia)	131	69	120	141	111	91
- Exports	119	64	148	146	112	103
- Imports	137	71	108	138	111	83

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

In 2008 there was a significant growth of demand for Belarusian production on Russian market, which was due to the accelerated pace of Russian economic growth and devaluation of Belarusian ruble against Russian currency. At the end of 2008, however, due to recession in both economies coupled with the global crisis there was a decline in demand on both markets. The development of Belarus-Russia trade in the following years, as before, was significantly dependent on the situation and demand in Russian economy.

Thus, 7,9% decline of Russia's GDP in 2009 triggered substantial slump of its demand for foreign goods which reflected in 36% decrease of Belarus' exports. Same situation was on Belarusian market that was able to absorb 29 % less imports from Russia then one year ago. The next years registered steady growth of Belarus' exports to Russia that ended in its historical maximum in 2013. This stable trend was firstly caused by general buoyancy of Russian economy revival of its domestic demand and secondly by almost three-fold devaluation of the Belarussian ruble in 2011. A significant contribution was also caused by the removal of all trade barriers for Belarusian goods due to its accession to the Customs Union. Increasing Belarusian exports is one of the main factors in its GDP growth (the share of exports in GDP is more than 50 %). Moreover, the share of the country's exports to Russian market represents almost 44 % of total exports in 2013, so that Belarus is considerably dependent on the solvency of Russian consumer market and on its demand for Belarusian production. Graph 6 shows the structure of Belarus' exports to Russia in 2012⁶⁶.

Table 6: Commodity structure of Belarus' exports to Russia in 2012

Commodity	Exports (mio USD)	Share of total (%)	% change to 2011
Machinery, equipment and vehicles	6 652	40,8	1,6
Food and agricultural raw materials	3 968	24,4	22,0
Chemicals and related products	1 627	18,5	18,5
Metals and metal products	1 321	8,1	14,6
Textile products and footwear	1 193	7,3	11,5
Other	1 549	0,9	-
Total	16 309	100	35,4

Source: Ministry of Economic Development of Russian Federation.

The structure of Belarusian exports to Russia is traditionally dominated by machinery, equipment and vehicles. As we can see from the table above, this group of goods accounted for 40,8 % of Belarus' exports to Russia in 2012 and amounted to 6 652 mio USD which comparing to the previous period represented a growth of 1,6 %.

Except machinery and equipment, a significant share of Belarusian exports to Russia held food and agricultural products that amounted to 24,4 % of total exports to Russia in 2012 (22 % higher than in 2011).

Supplies of chemicals and related products to Russia in 2012 increased by 18,5 % to 1 627 mio USD which was caused mostly by increased exports of fuels. Its share in the republic's exports to Russia also amounted to 18,5 %.

⁶⁶ The latest available annual report.

Metals and metal products amounted to 8,1 % of Belarus' exports to Russia in 2012. By the end of 2012 the value of this export group reached 1320,8 mio USD which was 14,6 % higher than the corresponding figure in 2011.

Textiles and footwear held share of 7,3 % in Belarus' exports to Russia in 2012 while the total value of delivered goods was 1 193,1 mio USD (11,5 % higher than in 2011).

The structure of imports from Russia to Belarus in 2012 was dominated by fuel and energy products which accounted for 62,3 % of total imports, the share of metals and products from them was 10,7 %, chemical products – 7,1 %. The share of machinery, equipment and vehicles was 10,4 %.

Table 7: Commodity structure of Belarus' imports from Russia in 2012

Commodity	Imports (mio USD)	Share of total (%)	% change to 2011
Fuel and energy products	11 795	62,3	12,6
Metals and products from them	2 948	10,7	9,8
Machinery, equipment and vehicles	2 873	10,4	29,3
Chemicals products	21 967	7,1	0,7
Food and agricultural raw materials	7747	2,7	12,5
Other	1 874	6,8	-
Total	27 551	100	59,40

Source: Ministry of Economic Development of Russian Federation.

In 2012 Belarus imported crude oil worth 8384,4 mio USD which was 12,6 % more than in 2011. The physical volume of Russian oil supplies grew by 17,7 % to 21,3 mio tons which indicates the growth of oil-processing industry in Belarus. Value of shipments of Russian gas in 2012 decreased in comparison with 2011 by 35,8 % to 3410,8 mio, quantitative indicators increased by 1,5 % to 20,3 bn m³ that says about substantial price reduction for Belarus that comes from its membership in the CU.

Deliveries of machinery, equipment and vehicles from Russia to Belarus came to 2872,2 mio USD at the end of 2012, which was 29,3 % higher than in 2011.

Belarus' imports of Russian metals and products from them for 12 months of 2012 amounted to 2947,8 mio USD, which was 0,7 % more than in 2011.

Imports of chemical products from Russia in January-December 2012 equaled to 1962,6 mio USD and thereby increased compared with January-December 2011 by 9,8 %.

Imports of food and agricultural raw materials from Russia in 2012 made up 746,6 mio USD – an increase of 12,5 % compared to 2011. For this group of goods there was growth in the physical volume of purchases of frozen fish (43,4 %), sunflower oil (2 times), bananas (99,4 %), margarine (68,1 %), chocolate (54,2 %), bread and flour

confectionery (38,7 %), juices, fruits and vegetables (20 %), mineral water (28,2 %), waste obtained in the manufacture of soybean oil (2,7 times). The majority of these changes can be explained by the introduction of the SCT and thereby increase of relative prices of the products that were previously imported from non-CU states (e.g. chocolate, sunflower oil and margarine – from Ukraine; frozen fish – from Norway). This is likely to be a sign of appeared trade diversion. Moreover, its effect on growth of competitiveness of some items of food and agricultural raw materials (e.g. bananas, mineral water) on Russian market made Russia's entry to the WTO that lowered majority of import tariffs for these product lines and thus made re-export of many products to Belarus more profitable than buying them on traditional markets.

Regardless of the fact that introduction of the SCT had some diversion effects on some of Belarusian import lines, we can conclude the development of trade between two states after creation of the CU had positive tendency. Thus, during the period between 2008 and 2012 Belarus' exports to Russia increased by almost 59% while imports grew by 17%. However, much stronger influence on Belarusian exports had Russia's entry to the WTO in 2012 that almost stopped the growth of Belarus' exports to Russia in 2013 and caused its relative decline in the first quarter of 2014.

Belarus-Kazakhstan

Belarusian exports to Kazakhstan in 2013 made up 868 mio USD – 7,6 % more than a year ago; imports from Kazakhstan amounted to 82 mio USD – a decrease of 31,8 % compared to 2011. The positive trade balance in this way amounted to 786 mio USD.

Table 8: Foreign trade between Belarus and Kazakhstan

Total value (mio USD)						
Year	2008	2009	2010	2011	2012	2013
Turnover (all countries)	71 952	49 873	60 168	87 178	92 464	80 231
Turnover (Kazakhstan)	537	388	871	811	926	951
- Exports	365	313	465	674	807	868
- Imports	172	75	406	137	119	82
- Balance	193	239	59	537	688	786
Relative change (% of previous year)						
Year	2008	2009	2010	2011	2012	2013
Turnover (all countries)	136	69	121	145	106	87
Turnover (Kazakhstan)	105	72	224	93	114	103
- Exports	101	86	148	145	120	108
- Imports	113	44	542	34	87	69

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

Belarus' exports to Kazakhstan were focused generally on industrial goods and food products while its structure was quite more heterogeneous compared to that of Russia.

The basis of Belarus' exports in 2013 was provided by the following products: milk and dairy products (8,8 % of exports), tires (7,4 %), tractors and truck tractors (6,9 %), the machinery for threshing (5,4 %), furniture (5,4 %), sugar (4,2 %); trucks ,cars, wood products, frozen beef, plastic products, railway coaches – each group amounting to 2,5-3,5 % of total exports.

The commodity structure of imports from Kazakhstan was mainly presented by raw materials and agricultural products. The main product lines included rolled metals (56,0 % of imports), raw aluminum (17,1 %), wheat (14,9 %), copper scrap (9,9 %), mixed mineral fertilizers (8,7 %), trucks (7,6 %) as well as smaller quantities of conveyor belts, bearings, petroleum products and electric batteries.

As we can see the creation of the CU gave a substantial impulse to the development of trade cooperation between two countries and resulted in 77% growth of mutual turnover since 2008. At the same time, the importance of Kazakhstan for Belarus increases with the fact that it currently provides the third highest figure of positive trade balance among Belarus' trade partners after the EU and Ukraine.

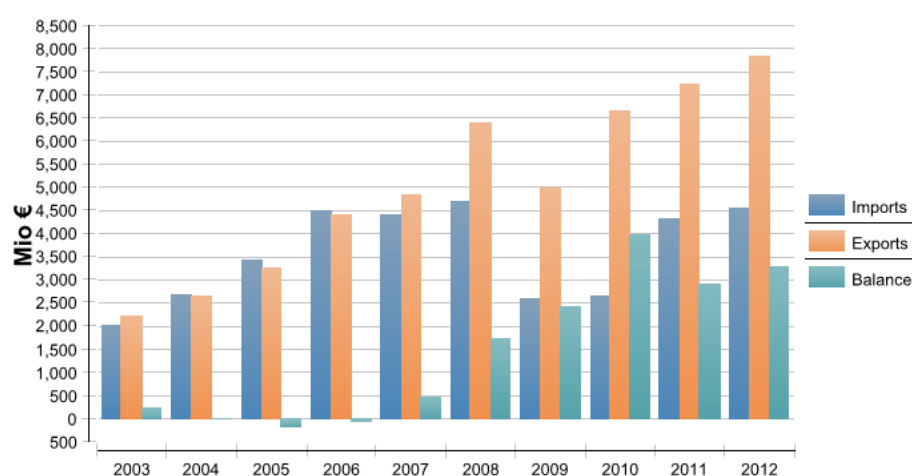
4.5. Belarus' foreign trade with the EU

In response to Belarus' lack of commitment to democracy and civil rights, the EU has not yet ratified the bilateral Partnership and Cooperation Agreement concluded with Belarus in 1995. Paradoxically enough, today's economic relations are based on the "Agreement between the European Economic Community and the European Atomic Energy Community and the Union of Soviet Socialist Republics on trade and commercial and economic cooperation" signed back in 1989. Finally, even these trade preferences were withdrawn by the EU in June 2007 in response to Belarus' violations of the core principles of the International Labor Organization. However, the removal of the trade preferences in 2007 did not halt Belarus' exports to the EU because it simply returned its import tariffs to the standard non-preferential rates. The EU has also introduced an Outward Processing Trade regime for Belarus which provides for additional import quota amounts for textiles and clothing manufacturers within the European Union so they can produce garments in Belarus that will return to the EU after processing⁶⁷

⁶⁷ The European Commission. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://ec.europa.eu/trade/policy/countries-and-regions/countries/belarus/>

If we want to characterize current Belarus-EU trade partnership, we should mark out some important features. First, despite political conflicts, visa restrictions and targeted economic sanctions the EU remains Belarus' second economic partner after Russia with almost a one third share in the country's overall trade. Second, the EU-Belarus bilateral trade in goods has been growing steadily over the last years. The graph below shows the development of trade balance between Belarus and EU in the latest years. As we can see, despite removal of trade preferences for Belarus in 2007 the trade balance between two partners has been steadily growing, giving Belarus one of the biggest positive balances among its trade partners.

Graph 1: Trade flows between the EU and Belarus, 2003-2012



Source: The European Commission. [on-line]. [cit. 2014-3-23]. Available from WWW:

http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113351.pdf

The structure of Belarusian exports to the EU remains relatively undiversified. Belarus' modest level of economic development prevents it from exporting big amounts of industrial products, while the Joint Agricultural Policy of the EU limits the potential market for Belarusian farmers. As, we can see from the table below, mineral fuels, lubricants and related materials recently made more than half of Belarusian exports to the EU. It is interesting that the Netherlands remain the biggest importer of Belarusian petrol and the third export partner in general, thus having a rather strong position on Belarus' politics at the same time.

Table 9: Commodity structure of Belarus' exports to the EU in 2012

Commodity	Share of total (%)
Mineral fuels, lubricants and related materials	53,8
Manufactured goods classified chiefly by material	15,3
Chemicals and related products.	12,8
Crude materials, inedible, except fuels	6,6

Machinery and transport equipment	3,6
Other	8,1

Source: Eurostat.

As for the EU exports to Belarus, it is mainly presented by machinery and transport equipment (half of total export), chemicals and manufactured goods (one third of export). The biggest part of exports comes from Germany, Poland and Italy. Although the EU exports to Belarus remain less than its imports, it is still less dependent from the outer factors and more stable with regard to high technologies in comparison with Belarusian export.

As regards the accession of Belarus to the CU, we can say that it did not have specific negative effects on its trade with the EU. During the whole period from 2009 till 2012 all major foreign trade indicators of Belarus' trade with the EU (including exports, imports and positive trade balance) were growing. In 2012, the trade turnover in goods between Belarus and the EU made up 27,1 bn USD. However, according to the latest data provided by Belarusian Statistics Committee, this figure has fallen by 21,8 % in 2013 while Belarusian exports to the EU decreased by 40,2%⁶⁸. The loss resulted primarily from suspense of the scheme of selling fuels disguised as solvents without paying export duties to Russia that in 2011-2012 brought more than 2 bn USD to Belarusian budget annually. This practice was stopped by Russia by the end of 2012. Next year, e.g., exports to Latvia that used to be the second biggest importer of Belarusian fuel in 2012 decreased by 87 %. Similar reason had the decrease of Belarus' exports to other EU countries – Poland, the Netherlands or Lithuania (for more, see part 4.3 Exports). As a result, today Belarusian balance of payments is experiencing real problems resulting from shortage of export incomes.⁶⁹

⁶⁸ News portal "BelPort". [on-line]. [cit. 2014-2-23]. Available from WWW: <http://belport.by/index.php?newsid=98783>

⁶⁹ Analytic portal "Belarus Digest". [on-line]. [cit. 2014-2-23]. Available from WWW: <http://belarusdigest.com/story/other-pole-13977>

6.1. To conclude, we should say that despite on-going politic disputes and targeted economic sanctions the EU remains Belarus' second economic partner and their mutual economic cooperation intensifies. Moreover, trade with the EU provides one of the highest positive balances and is perceived by the government as one of the key instruments to revive Belarusian economy after recent economic crises. At the same time the structure of Belarusian exports remains undiversified and is continuously dominated by mineral fuels and petrochemicals that Belarus produce from subsidized Russian oil which Belarus buys more than 2 times cheaper than the world price(for more, see 6.3. Narrowing of the breadth of Belarusian foreign trade

Foreign trade is vital for Belarus' economy and traditionally generates about half of its GDP. Despite substantial world market shares in some products like potash fertilizers or mining dump trucks, Belarusian trade has very strong regional focus. USSR heritage results in developed heavy machinery industry, but also in very high dependence on imports, especially minerals necessary for development of its machinery and petrochemical industries. It can be seen, e.g., from traditionally high percentage (50-60 %) of imports from Russia which are mostly minerals. This aspect is one of the reasons why Belarus' has traditionally had low characteristics of breadth of trade. Thus, according to DHL Global Connectedness Index, Belarus has one of the most regionally concentrated trade structures in the world which resulted in its 117th position out of 140 countries in breadth of trade in

2011. The figure indicates strong focus of Belarus' foreign trade on limited number of countries and critically narrow breadth of its trade connections. Picture 5 illustrates the destinations of Belarusian exports (countries are sized in proportion of their share in Belarus' exports and are colored in proportion of Belarus' share in their imports).

Picture 13: Belarus' merchandise exports, 2011

Source: DHL Global Connectedness Index. [on-line]. [cit. 2014-3-23]. Available from WWW:

<http://www.dhl.com/content/dam/flash/g0/gci/download/BLR.pdf>

The process of narrowing the breadth of Belarus' foreign trade is not only a matter of nowadays but has already had place at least for last decade and intensified after Belarus entered the Customs Union in 2010. According to the data from the DHL Global Connectedness Index, since 2005 Belarus has come down by 13 positions in breadth of foreign trade and occupied 117th place among 140 observed countries in 2011. The share of trade on the same continent in 2011 amounted to 85 % while in 2005 it was only 35 %. Thereof, we can notice that Belarus' foreign trade policy is continuously inclining towards concentration on Eurasian post-Soviet markets (especially Russian) at the expense of other countries. From this reorientation especially suffers trade with the EU – the market that until 2013 unlike other trade partners had generated positive trade balance for Belarus. As could be clearly seen before from Table 19 the share of Belarus' exports to the EU has been continuously falling from 29,5 % in 2008 to 21,0 % in 2012. The same tendency is observed by imports from the EU. It finally led to the shrinkage of the EU-Belarus turnover for more than 7 % during 4 years since 2008. At the same time the importance of Russian market for Belarussian goods has been growing steadily. Thus, Russian share in Belarusian exports increased for about 13 % from 2008 till 2013 while Russia steadily maintained about half of Belarus turnover since Belarus got its independence in 1990. It is a clear sign of Belarus' continuous trade dependence on Russia and regime's politic and economic narrow-mindedness. Instead of trade diversification, the government has been continuously intensifying economic relations with its eastern partners that concluded with Belarus' entrance to the Customs Union (for more, see **Chyba! Nenalezen zdroj odkazů**.2. Effects of the CU on Belarus' foreign trade flows).

Table 19: Shares of Belarus' partners in it foreign trade turnover (% of total)

Year	2008	2009	2010	2011	2012	2013
With Russia	47,3	47,0	46,6	45,2	47,4	49,5
- Exports	32,4	31,5	39,4	35,0	35,4	45,2
- Imports	59,7	58,5	51,8	54,5	59,4	53,2
With Kazakhstan	0,7	0,8	1,4	0,9	1,0	1,2

- Exports	1,1	1,5	1,8	1,6	1,8	2,3
- Imports	0,4	0,3	1,2	0,3	0,3	0,2
With other countries of the CIS	8,0	7,4	8,8	9,4	9,8	9,4
- Exports	10,6	10,7	12,7	12,5 %	14,3	14,3
- Imports	5,8	5,0	5,9	6,6	5,3	5,2
With the EU	23,1	20,6	19,6	17,7	16,5	-
- Exports	29,5	31,7	33,4	23,3	21,0	-
- Imports	17,8	12,3	9,6	12,6	12,1	-
With the rest of the world	20,9	24,2	23,6	26,7	25,2	-
- Exports	26,4	24,6	12,7	27,5	27,5	-
- Imports	16,3	23,9	31,5	26,0	22,9	-

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

Dependence on oil-processing industry vs. Energy dependence from Russia). According to the latest announcements⁷⁰, in 4-5 years Russia is going to apply same-price principle for oil and natural gas for all countries. For Belarus that means not only partial loss of profits from its oil-processing industry but also inability to compete on foreign markets due to increased costs of production. Therefore, Belarus needs serious efforts to modernize its economy and make it less energy-dependent. The EU assistance and experience in this sphere could be very useful. For now, unfortunately Belarusian will for cooperation breaks at the EU's requirements for democratization and reforms which are as unpleasant for Lukashenka as for its Russian vis-à-vis.

4.6. Belarus' foreign trade with Ukraine

While speaking about Belarus' foreign trade in goods it would be logical to have a look at Ukraine that according to the National Statistical Committee of the Republic of Belarus was Belarus' third most important trade partner after Russia and the EU in 2013 with 7,8 % of total turnover. The southern neighbor of Belarus is also particularly interesting due to specifics of its recent political and economic situation that in the future can have a significant effect on geographical and quantitative structure of Belarus' exports. The development of mutual trade in goods between two countries depicts the table below.

Table 10: Foreign trade between Belarus and Ukraine

Total value (mio USD)						
Year	2008	2009	2010	2011	2012	2013
Turnover (all countries)	71 952	49 873	60 168	87 178	92 464	80 231
Turnover (Ukraine)	4 893	2 982	4 439	6 195	7 867	6 252
- Exports	2 778	1 692	2 560	4 160	5 557	4 195
- Imports	2 115	1 290	1 879	2 035	2 310	2 057
Balance	663	402	681	2 125	3 248	2 139

⁷⁰ News portal "Charter97". [on-line]. [cit. 2014-2-23]. Available from WWW: <http://charter97.org/ru/news/2013/10/17/77812/>

Relative change (% of previous year)						
Year	2008	2009	2010	2011	2012	2013
Turnover (all countries)	136	69	121	145	106	87
Turnover (Ukraine)	163	61	149	140	127	79
- Exports (USD, mil)	189	61	151	162	134	75
- Imports (USD, mil)	138	61	146	108	113	89

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

During 2000s there has been a stable trend of growing turnover between two countries which culminated with both maximum exports and imports in 2008. Then both countries were strongly affected by the global economic crisis and fall of demand on foreign markets that finally reflected in almost 40 % plunge of all trade indicators in 2009. The following years 2010-2013 were characterized by general recovery of both economies and thus increase of demand for imports. That lead to the recurrence of Belarus' imports from Ukraine to per-crisis figures by the end of 2011 while exports to Ukraine same year grew by almost half compared to 2008. The next year 2012 registered further 27 % growth of mutual turnover when again Belarus' exports significantly exceeded its imports and trade balance value reached its maximum for their whole independent history. Partly the mutual turnover growth was a consequence of the CIS Free-Trade Area agreement that was ratified by Ukraine on August 9, 2012 and thus created a full-value free trade zone between Belarus, Ukraine and Russia from September 20, 2012⁷¹.

Belarus' major exports to Ukraine have been traditionally dominated by following product groups: mineral products, vehicles, machinery and equipment. There has been an absolutely clear trend of increasing share of mineral products in Belarus' exports since 2008. Later this trend became apparent and reached its peak in 2010, when mineral products accounted for more than 60 % of Belarusian exports to Ukraine. Simultaneously, there was a sharp decline in the share of vehicles (3-5 times), machinery and equipment (2-3 times). If we look at the detailed structure of Belarusian-Ukrainian trade turnover, it becomes clear that tremendous growth of exports in the group of mineral products was composed mainly by fuels and petroleum products refined from subsidized Russian oil rather than by locally excavated potash fertilizers. The dynamics of these two export groups is reflected in the following table.

⁷¹ CIS FTA is a free trade agreement signed on 18 October 2011 among 8 CIS member states: Russia, Ukraine, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan, Moldova and Armenia, later they were followed by Uzbekistan. Azerbaijan and Turkmenistan, although CIS members, did not sign this FTA agreement. As of March 2014, it has been ratified by Ukraine, Russia, Belarus, Moldova, Uzbekistan, Kazakhstan, Kyrgyzstan and Armenia.

Table 11: Share of mineral resources in Belaruian exports to Ukraine, 2007-2010

Year	2007	2008	2009	2010
Fuels and petroleum products (mio USD)	365,5	1177,3	974,8	1526,7
- % of total exports	24,9 %	42,3 %	57,6 %	59,6 %
Potash fertilizers (mio USD)	55,6	123,9	5,8	41,9
- % of total exports	3,8 %	4,4 %	0,3 %	1,6 %
Balance in case of absence of mineral products in Belarus' exports (mio USD)	430,0	-514,6	-573,3	-845,9

Source: Expert community "Nashe Mneniye". [on-line]. [cit. 2014-2-14]. Available from WWW:

<http://nmnby.eu/news/analytics/4825.html>

The table above clearly shows catastrophic state of Belarusian exports to Ukraine, degradation of Belarus' economy and strengthening of this trend. Only by selling fuels and petroleum products Belarus has been recently managing to offset the enormous deficit which would appear in case of trade with non-mineral commodities. It should be noted that the share of fuels and petroleum products in Belarusian imports to Ukraine increased even during the cooling of Belarusian-Ukrainian relations that proves the fact that politics had only a slight effect on the willingness of Belarusian leadership to earn on sale of petroleum products from cheap Russian oil. It also underlines the importance of this export group for profit generation and maintenance of the whole economy. The alarming sign gives also the continuously declining since 2008 share of domestically made food products that may indicate shrinkage of competitiveness of Belarusian agricultural sector itself. Originally Belarusian exports in many positions have an obvious downward trend since 2008, at some positions at times. Thus, analysis of Belarus' exports to Ukraine testifies to preservation and simultaneous degradation of Belarus Soviet economic legacy.

The structure of Ukrainian imports in Belarus has been more stable. In this case, there is no obvious sign of re-exports but clear domination of domestic production. The biggest part of goods imported from Ukraine is composed by products of ferrous metallurgy and agriculture. Their recent share in constantly growing Ukrainian imports to Belarus did not change by more than 15 %. As in case of Belarus, the Soviet economic legacy in Ukraine is still preserved, but with a tendency towards its modernization.

What concerns the year 2013, mutual trade turnover between two countries fell by 21 % while positive trade balance for Belarus dropped only by 11 %. These figures prove the on-going trend when Belarusian exports exceed imports from Ukraine. Since 2008 this gap has increased significantly, turning Ukraine into important link in solving the problem of Belarus' chronic foreign trade deficit. But the situation is changing rapidly. Due to continuing unstable political situation the economy of Ukraine is seriously stagnating and

according to the World Bank the country's GDP will decrease by at least 3 % in 2014 while the first signs of recovery even on the most favorable condition of prompt structural and economic reforms will be seen not earlier then in 2015⁷². For Belarus that means a decline of its exports to Ukraine and possibly disappearance of so important source of positive trade balance. The situation got even worse after Ukraine left the CIS in March 2014 and so the CIS Free Trade Agreement that enabled tariff-free trade with goods on the territory of the Commonwealth (except Azerbaijan and Turkmenistan). It means a further relative price rise of Belarusian exports and reduction of Belarus-Ukraine trade turnover.

⁷² BBC news. [on-line]. [cit. 2014-2-23]. According to:
http://www.bbc.co.uk/ukrainian/ukraine_in_russian/2014/04/140404_ru_s_world_bank_report.shtml

5. Statistical analysis of Belarus' performance in the CU

After have given a general outlook on the structure of Belarusian economy and foreign trade in the previous part, this part will provide reader with statistical analysis of Belarus' economic performance in the CU including evaluation of its impacts on Belarus' foreign trade flows, level of foreign investments and growth of state budget. Afterwards we will describe the economic problems that appeared or intensified in Belarusian economy after Russia entered the WTO in 2012.

5.1. Potential effects of CU tariff changes on Belarusian economy

Belarus, Kazakhstan and Russia introduced a single customs tariff from January 1, 2010. The effects of these tariff changes are generally twofold. On the one hand, the removal of internal tariffs and reduction in external tariffs could lead to trade creation – a term coined by Viner (1950) and referring to a generally welfare enhancing effect as consumers are given the opportunity to buy from more efficient foreign producers. In the context of the customs union this effect could be expected due to reduction in certain tariffs for third countries (tariffs on internal trade were already largely absent under various bilateral treaties).

On the other hand, regional customs unions can also result in “too much” trade between the countries involved and not enough trade between the bloc and the outside world (trade diversion). This leads to direct welfare losses because consumers have to either pay more for high-quality products from outside the union or put up with inferior or costlier products supplied by less efficient local producers. In the context of the customs union this may occur in response to increases in external tariffs.⁷³

Indeed, the common tariff of the customs union was negotiated in 2009 at the height of the global economic crisis and was viewed by many as an instrument to lock in some protectionist measures imposing higher tariffs on imports from non-CIS countries

⁷³ EBRD. *How much do tariffs matter? Evidence from the customs union of Belarus, Kazakhstan and Russia*. Working Paper No. 154. January, 2013. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://www.ebrd.com/downloads/research/economics/workingpapers/wp0154.pdf>

such as China, Germany or Turkey. That is why while estimating the potential for trade diversion in a particular country, Belarus in our case, we should take into consideration several factors:

- relative change of its effective tariffs due to applied single customs tariff (SCT),
- structure of the country's trade balance and share of imports from inside and outside the CU before and after joining the integration,
- structure of country's imports and extent of overlaps between different trading partners exporting same goods to the country.

What concerns relative change in Belarusian **effective tariffs**, then we should notice that it has not been so dramatic. The simple average tariff decreased insignificantly, while weighted average tariff slightly grew up and accounted for 10,34 % (see Table 12). As far as tariff level in Belarus almost did not increase, we can assume that the prerequisites for trade diversion were not excessive.

Table 12: Level of tariff protection in Belarus before and after its entry to the CU

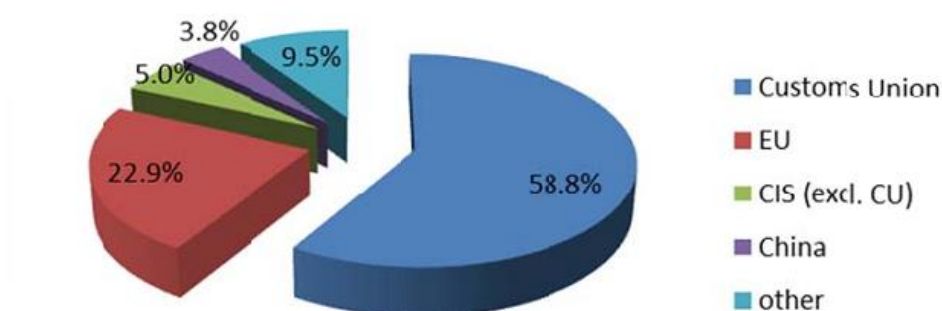
	Before CU	After CU
MFN applied tariff (AV + AVE)		
MFN applied tariff (AV + AVE), simple average (%)	10.89	10.45
MFN applied tariff (AV + AVE), dispersion (%)	0.7	0.9
MFN applied tariff (AV + AVE), weighted average (%)	9.29	10.34
Tariff Peaks		
Share of tariff lines with domestic peaks (value above 3 times the simple average tariff) (%)	1.97	0.78
Share of tariff lines with international peaks (applied tariff rates that exceed 15 percent) (%)	13.74	17.13

Source: TOCHITSKAYA, I. *The Customs Union between Belarus, Kazakhstan and Russia: an overview of economic implications for Belarus*. Center for Social and Economic Research, Warsaw. 2010. [on-line]. [cit. 2014-2-24]. Available from WWW: <http://www.isn.ethz.ch/Digital-Library/Publications/Detail/?ots591=0c54e3b3-1e9c-be1e-2c24-a6a8c7060233&lng=en&id=120720>

The same conclusion could be drawn based on analysis of Belarusian **trade balance and shares of its import partners**. Graph 5 shows the structure of Belarus's imports in the year preceding the formations of the CU (2009). The majority of imports (about 60 %) comes from the CU which supplements our suppositions of the CU neighbors being natural trade partners of Belarus. The EU accounts for about a quarter of Belarusian imports while China, other CIS countries from outside the CU and the rest of the world are relatively less important in terms of imports shares. This suggests that the potential of trade

diversion in Belarus should be relatively low due to traditionally wide presence of Russian and Kazakhstan exporters on its market.

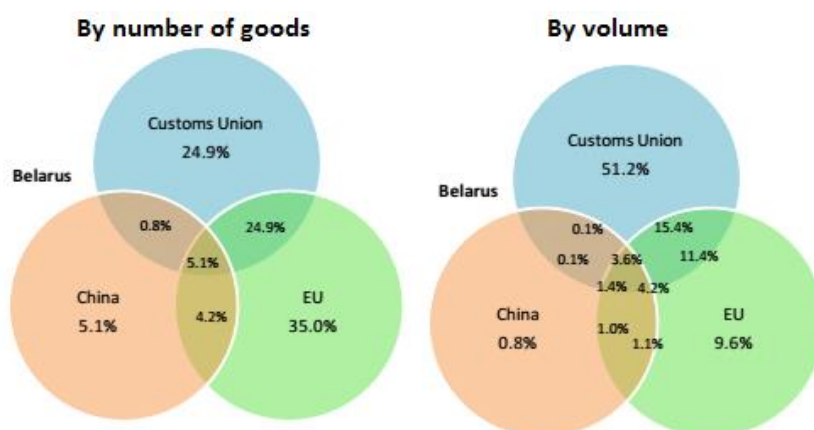
Graph 5: Shares Belarus' import partners, 2009



Source: EBRD. *How much do tariffs matter? Evidence from the customs union of Belarus, Kazakhstan and Russia*. Working Paper No. 154. January, 2013. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://www.ebrd.com/downloads/research/economics/workingpapers/wp0154.pdf>

To further gauge the potential of trade diversion effects for Belarus we can look at the **overlap between different trading partners** exporting same goods to Belarus. Graph 5 shows that this indicator is substantial for Belarus' key trading partners – the EU, China and CU members. According to the data from the chart, only 5,1 % of all goods lines (by number) have simultaneously recorded imports from China, the EU and CU countries. Other 24,9 % of goods lines are shared between the CU and the EU. By contrast, 35 % of lines are imported exclusively from the EU and about 5 % exclusively from China. Even though the overlaps in case of Belarus are relatively small they still provide for potential trade diversion effects in trade with the EU which has a quarter of goods lines exported to Belarus equal to those coming from other CU countries. In the future implementation of a SCT could significantly reduce the amount of specific import lines from the EU and consequently lower the welfare of Belarusian consumers.

Chart: Overlap between imports from key trading partners by number of goods and by volume, 2009



Source: EBRD. *How much do tariffs matter? Evidence from the customs union of Belarus, Kazakhstan and Russia*. Working Paper No. 154. January, 2013. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://www.ebrd.com/downloads/research/economics/workingpapers/wp0154.pdf>

At the same time, the European Union is much more important sole trading partner for Belarus than China. This tentatively suggests a greater scope for trade diversion with respect to China as imports from the European Union may be harder to replace with imports from other trading partners, at least in the short run, based on existing trade relationships.

The picture is quite different if one looks at the volumes traded rather than the number of line items. There is a much larger share of imports from within the CU by volume rather than by number of goods. These increase to 51,2 %, driven mostly by Russia fuel resources, which aggregated about 60 % of Belarusian intra-CU imports.

As far as the level of tariff protection after implementation of a SCT almost did not change and almost two thirds of Belarusian imports previously originated from CU partners, we can anticipatorily conclude that the overall effect of the CU on Belarusian economy should be more trade creating than trade diverting. This assumption is furthermore strengthened by the fact that Russia can be considered as a natural trading partner⁷⁴ of Belarus. Witness for this assumption can be several arguments:

- Russia and Belarus are major trading partners. Before creating the CU Russia's share in the exports of Belarus amounted to 32,2 % in 2008, while imports from Russia reached 59,8 % in the same year. Later on this interdependence even deepened that led to the increase of Russia's share in Belarusian exports at 45,2 % by the end of year 2013⁷⁵;
- The countries are close geographically while the state boundary with Russia is the longest one among those of Belarus' neighbor countries. Moreover, Belarus is geographically close to major centers of Russian consumption (European part of Russia is home to 78 % of its population) and from 2011 has no transport control on the boundary with Russia;
- The countries are close culturally and there is no major language and mental barriers between them.

⁷⁴ The natural trading partner hypothesis suggests that trade creation will be greater relative to trade diversion if the two countries involved are already major trading partners and are close geographically. This hypothesis suggests two potential variables that might be correlated with TC and TD: log distance between the countries and the share of each country's imports that come from the partner in the year prior to the RTA.

⁷⁵ According to the National Statistical Committee of the Republic of Belarus.

These suppositions correspond to official sources that report rather positive trends in Customs Union trade. According to the statistics published by the Eurasian Economic Commission, mutual trade volumes within the CU grew on a year-on-year basis by 29 % in 2010, 34,6 % in 2011 and 13,5 % in 2012, thus underpinning a rather strong trend of intra-CU trade increase.

Nevertheless, the preliminary total results are rather positive, the situation in particular sectors can appear to be different because big share of CU trade is occupied by mineral resources. Hence, in order to make a tentative conclusion on whether the initial integration managed to encourage trade flows in the sectors most susceptible to trade liberalization within the CU and the CES (those with higher added value, such as metallurgy, machinery and equipment) a deeper analysis of bilateral sectoral trade between the CU member states is required.

5.2. Effects of the CU on Belarus' foreign trade flows

If we look at the trends in Belarus' foreign trade inside the CU during last 6 years, we can see that it can be divided into 3 major periods:

- 2008-2009: the period that coincided with the peak of global economic crisis and thus was characterized with dramatic plunge in all macroeconomic indicators including imports and exports. In 2009, for example, Belarus' exports to the CU partners amounted to 64 % of the previous year, imports also dropped significantly and came up to 71 % comparing to the level of 2008.
- 2010-2011: the period which concurred with extensive anti-crisis financial inflows made by the government in order to revitalize the economy and 185 % devaluation of national currency during 2011 that aimed to support Belarusian exports. The huge effect was made by implementation of SCT and Common Customs Code in 2010 that helped significantly increase the volume of intra-CU trade. It was defined by significant increase in Belarus' foreign trade that consequently helped it reach almost all pre-crisis exports figures by the end of 2010.
- 2012-2013: the period of slowing down the rates of Belarus' foreign trade growth when Belarus' trade turnover with its neighbors from the CU increased by 11 % in 2012 and then decreased by 9 % in the following year. The situation can be mainly explained by Russia's membership in the WTO since August 2012 that lead to the

general increase of competitiveness on CU market and consequently decreased the demand for Belarus' export goods (for more, see 5.5 Effects of Russia's entry to the WTO on Belarus).

In goods

As we can clearly see from Table 12, since the launch of the CU in 2009 till 2012 trade between the three countries has been growing rapidly. For instance, Belarus' turnover with Russia and Kazakhstan has grown by almost 88 % between 2009 and 2012. Most of this increase, however, reflected post-crisis recovery trends (trade turnover was only 18 % higher in 2013 than in 2008). Same tendency had Belarus' intra-CU exports that due to continuous growth during whole observed period increased by over 62 % compared to the level of 2008. However, year 2013 registered a significant change in mutual trade inside the CU, caused by significant drop of Belarus' imports. Finally, it resulted in 9 % decrease of Belarus' turnover with Russia and Kazakhstan in 2013.

Table 12: Geographical structure of Belarus' foreign trade

Year	2008	2009	2010	2011	2012	2013
With Russia	47,3	47,0	46,6	45,2	47,4	49,5
Exports	32,4	31,5	39,4	35,0	35,4	45,2
Imports	59,7	58,5	51,8	54,5	59,4	53,2
With Kazakhstan	0,7	0,8	1,4	0,9	1,0	1,2
Exports	1,1	1,5	1,8	1,6	1,8	2,3
Imports	0,4	0,3	1,2	0,3	0,3	0,2
With other countries of the CIS	8,0	7,4	8,8	9,4	9,8	9,4
Exports	10,6	10,7	12,7	12,5	14,3	14,3
Imports	5,8	5,0	5,9	6,6	5,3	5,2
With the EU	23,1	20,6	19,6	17,7	16,5	-
Exports	29,5	31,7	33,4	23,3	21,0	-
Imports	17,8	12,3	9,6	12,6	12,1	-
With the rest of the world	20,9	24,2	23,6	26,7	25,2	-
Exports	26,4	24,6	12,7	27,5	27,5	-
Imports	16,3	23,9	31,5	26,0	22,9	-

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

In case of intra-CU imports to Belarus we can speak about its significant increase after application of SCT in January 2010. Thus, the amount of imports in 2011 grew by 36 % comparing to the level of previous year.

Table 13: Extra-CU foreign trade of Belarus

Total value (mio USD)						
Year	2008	2009	2010	2011	2012	2013
Turnover:	37 356	26 041	31 263	46 928	47 678	39 562
- Exports	21 654	14 273	14 865	26 236	28 944	19 533
- Imports	15 702	11 768	16 398	20 692	18 734	20 029
Balance	5 952	2 505	-1 533	5 544	10 210	-496
Relative change (% of previous year)						

<i>Year</i>	<i>2008</i>	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>
Turnover:	140	70	120	150	102	83
- Exports	144	66	104	176	110	67
- Imports	139	75	139	126	91	107

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

What concerns Belarus' non-CU trade relations, we should remark that the turnover with this group of countries has been continuously growing since 2009 till 2012 when Belarus' positive trade balance with these countries reached its historical maximum of 10 210 mio USD. As we can clearly see from Table 13, introduction of SCT in January 2010 and CCC in July 2010 had almost no negative impact on volume of imports from non-CU countries. On the contrary, there was a 39 % increase of this indicator in 2010 and 26 % in 2011. In general, since 2008 (the year prior to Belarus accession to the CU) till 2013 the amount of imports from non-CU states to Belarus increased by 29 %.

Same situation applies to Belarus' non-CU exports which were generally growing from 2009 till 2012 since there were no major changes in rules and tariffs applied by these countries to Belarusian goods that time. Moreover, they were substantially supported by multiple devaluations of Belarusian ruble conducted by the government in 2011. Thus, by the end of 2012 the non-CU exports increased by almost 34 % compared to pre-crisis year 2008. This increase was mainly given by the growing exports of petroleum products and fuels to the countries of the EU that in 2012 participated on 86 % of total non-CU exports of Belarus. The 33 % decrease in 2013 was mainly caused by the significant drop of petroleum products supply to the EU that had also its impact on lowering of total turnover.

Conclusions. In general, the estimated effects of Belarus' accession to the CU on its trade in goods point no noticeable signs of trade diversion because the proportion of imports from inside and outside the CU almost did not change (see Table 14). The whole period from 2008 till 2013 was dominated by intra-CU imports whose share in different years ranged between 53 % and 60 %. In general, the fluctuation of extra- and intra-CU shares was more correlated with the development of demand on foreign markets rather than with application of SCT and thus favoring CU producers. On the contrary, together with intra-CU imports similarly grew the value of imports from major non-CU import partners of Belarus – China, the EU and Ukraine.

Table 14: Share of extra-CU and intra-CU imports in Belarus' foreign trade in 2008 and 2012

Year	2008	2009	2010	2011	2012	2013
Extra-CU imports (mio USD)	15 702	11 768	16 398	20 692	18 734	20 029
- share in total imports (%)	40	41	47	45	40	47

Intra-CU imports (mio USD)	23 679	16 801	18 486	25 067	27 670	22 970
- share in total imports (%)	60	59	53	55	60	53

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

As was already mentioned, positive effects of the CU include increase of trade between unified states. For the period from 2008 till 2012, e.g., Belarus' trade turnover with CU countries increased by 29 % (29 % growth in trade with Russia and 72 % with Kazakhstan). If we suppose that the period of our comparison starts from 2009 (the year that came before application of the CCC), Belarus' intra-CU turnover grew by whole 88 %. On the contrary, the value of extra-CU turnover with Belarus in the same period decreased by 19 %.

Table 15: Share of extra-CU and intra-CU exports in Belarus' foreign trade in 2008 and 2012

Year	2008	2009	2010	2011	2012	2013
Extra-CU exports (mio USD)	21 654	14 273	14 865	26 236	28 944	19 533
- share in total exports (%)	66	67	59	63	63	52
Intra-CU exports (mio USD)	10 917	7 031	10 419	15 182,8	17 116	10 917
- share in total exports (%)	34	33	31	37	37	48

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

When we look at the effect of the CU policy on development of Belarus' exports, we can see that its geographical structure also almost did not change: compared to 2008 the share of intra-CU exports in 2012 increased insignificantly by only 3 %. From one point of view, there were no substantial qualitative changes in the structure of CU production that could substitute traditional imports from non-CU countries (e.g. modern machinery and vehicles from the EU, electronics and computers from China). From another point of view, Belarus used advantage of the EU's (about 86 % of Belarus' extra-CU exports in 2012) willingness to diversify its imports of oil and petroleum products and thus noticeably increased (re)exports of these products there. Otherwise, the decline of Belarus' extra-CU exports would be much more significant. However, the situation changed radically in 2013 when the intra-CU share of imports increased by 12 % at one time. The decrease of extra-CU share of exports primarily resulted from stop of Belarusian scheme of selling petroleum products and fuels disguised as solvents to the EU in 2012 (for more, see 4.5. Belarus' foreign trade with the EU).

While tariff changes presumably seemed to be statistically significant, they appeared to be moderate in terms of their magnitude. In fact, tariff changes explain only smaller part of the imports' variations, suggesting that tariff barriers may be less important than commonly believed. Thus, significant increase in intra-union trade appears to be attributable exactly to the lowering of non-tariff barriers within the customs union, as well

as other unobserved factors. Further reduction of non-tariff barriers and liberalization of access to both goods and services markets brought tangible and sustained benefits to customs union members. These are likely to be much more important – but they are also even harder to measure.

In services

As we can see from table below, there is a distinct trend of Belarus' growing foreign trade balance in services which in 2013 reached amount of 2 838 mio USD. The size of trade turnover in services has been constantly growing since 2009 till 2013 by about 19 % annually with similar tendency for both exports and imports.

Table 16: Belarus' foreign trade with services.

	2008	2009	2010	2011	2012	2013 ⁷⁶
Trade turnover (mio USD)	7 338	5 933	7 379	9 160	10 488	8 967
Export (mio USD)	4 590	3 715	4 501	5 804	6 646	7 300
- CIS ⁷⁷	30 %	29 %	30 %	29 %	33 %	34 %
- extra-CIS	70 %	71 %	70 %	71 %	67 %	66 %
Import (mio USD)	2 748	2 218	2 878	3 356	3 842	4 461
- CIS	37 %	37 %	33 %	31 %	31 %	33 %
- extra-CIS	63 %	63 %	67 %	69 %	69 %	67 %
Balance (mio USD)	1 842	1 497	1 623	2 448	2 804	2 838

Source: Ministry of Foreign Affairs of Belarus, National Statistical Committee of the Republic of Belarus.

Own calculations.

More than 51 % of the total Belarusian exports of services in 2013 were made up by transport services, reflecting favorable geographical position of Belarus. Among other major export positions were also IT and construction services. The main trade partners of Belarus in export of services were the EU (about half of total exports) and Russia (a quarter of exports).⁷⁸

What concerns the structure of Belarus' imports of services in 2013, the main share (38 %) as in case of exports was maintained by transport services that were followed by construction (16 %), IT and financial services (both about 5 %). The geographical structure of Belarus' imports of services was mainly represented by non-CIS countries (dominated by the EU) whose share by the end of 2013 amounted to 67 % of total imports value.

⁷⁶ News portal "Belapan". [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://belapan.com/archive/2014/02/26/683815/>

⁷⁷ Unfortunately due to absence of official statistical information about volume of Belarus' foreign trade in services with particular countries the information about CIS and non-CIS countries was used. However, the development of data for CIS-countries should correspond with the CU-trends because the share of the CU countries in Belarus' trade with CIS during the whole period has been relatively stable and amounted to about 85% on average, see more: <http://nmnby.eu/news/analytics/4971.html>

⁷⁸ Ministry of Foreign Affairs of the Republic of Belarus. [on-line]. [cit. 2014-2-23]. Available from WWW: http://www.mfa.gov.by/en/foreign_trade/

Imports from non-CIS countries grew by 15 % compared to the previous year, with CIS countries – by 12 %.⁷⁹

The geographical structure of Belarus' foreign trade in services has been clearly dominated by extra-CIS countries (mostly the EU) in both imports and exports where their share amounted to about two thirds of total trade volume in the last 6 years. This proportion was quite stable and almost did not change after creation of the CU, compared to foreign trade with goods which was seriously affected by the implementation of the SCT.

On the whole, we can conclude that Belarus' accession to the Customs Union had no negative effect on its foreign trade in services and just corresponded with general positive tendency that settled down before. For the period from 2008 till 2013 Belarus' annual imports of services grew by 62 % while exports – by 59 %. Normally the growth was caused by positive economic development on the most important for Belarus foreign markets (the EU and the CU) and by growth of investment inflows to Belarus' tertiary sector.

5.3. Effects of the CU on Belarus' foreign investment inflows

Establishment of the Customs Union of Belarus, Russia and Kazakhstan exacerbated some painful problems for Belarus' investment attractiveness. On the one hand, the new integration has significantly raised competition for investments between its member states that have an unlimited sovereign right to set its own rules for foreign capital. On the other hand, the basic liberalization of cross-border linkages across the member countries expanded options for investors to choose place for tax registration and actual localization of their activities.

The competition for investments intensified noticeably from 2012 when common economic space of the EurAsEC Customs Union came into effect. It was the next step after economic integration and except mutual protectionism assigned by agreement about creation of the CU ensured the so-called “four freedoms” among the participating states: the free movement of goods, capital, services and labor.

⁷⁹ News portal “Vsy Byelarus”[on-line]. [cit. 2014-2-23]. Available from WWW: <http://allby.tv/article/53/import-uslug>

Analysis of business and investment environment in Belarus shows that the country has partly improved its position in this aspect in recent years. This conclusion was made according to the Doing Business Report, a study elaborated by the World Bank Group that measures the costs to firms of business regulations in 183 countries in the world. As shows Table 17, CU countries are not so highly ranked in this report, but we can note recent substantial progress of Belarus and Kazakhstan against the background of regain of its former pre-CU position.

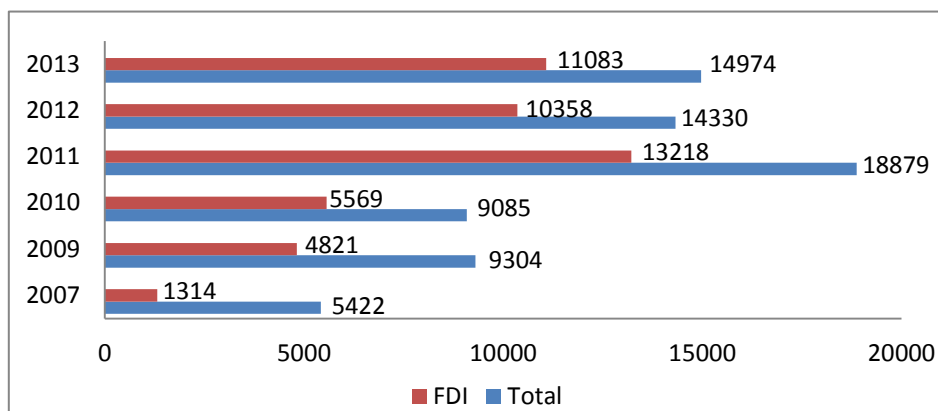
Table 17: Positions of Belarus, Russia and Kazakhstan in the Doing Business report

Ranking	Belarus			Russia			Kazakhstan		
	2007	2011	2014	2007	2011	2014	2007	2011	2014
DOING BUSINESS RANK	129	68	63	96	123	92	63	59	50
Starting a Business	148	7	15	33	108	88	40	47	30
Dealing with Construction Permits	84	44	30	163	182	178	119	147	145
Protecting Investors	142	109	98	60	93	115	46	44	22
Paying Taxes	175	183	133	98	105	56	66	39	18
Trading Across Borders	113	128	149	143	162	157	172	181	186
Getting Credit	117	89	109	159	89	109	48	72	86

Source: The World Bank.

As we can see, after launch of the CU in 2010 Belarus has generally improved its position in the majority of rankings while the positions of Russia and Kazakhstan worsened in some categories significantly. Simultaneously there is a criterion where the position of all CU states has been continuously very low and even worsened due to their entry to the CU – trading across borders. It means that CU businesses, primarily private and medium-sized, face serious institutional and administrative barriers for trade with other countries, but at the same time are supposedly better protected from foreign competitors. Nevertheless, Belarus remains on the highest position in trading across borders among CU countries that together with its favorable geographical position between big markets of Russia and the EU creates favorable conditions for FDI inflows in export-oriented industries. A similar conclusion can be drawn with respect to Russia's and Kazakhstan's low positions in obtaining construction permits for so-called “green field” investments – the ones that traditionally attract most innovative industries. Here Belarus has always been a leader and, as we can see from Table 17, made a real breakthrough in comparison with 2007. At the same time Belarus is seriously behind its CU neighbors in such important capital-attracting indexes as paying taxes and protecting investments.

Graph 6: Foreign investment inflows to Belarus (mio USD)



Source: Ministry of Economy of Belarus.

If we look at the development of investment inflows to Belarus before and after its accession to the CU, we can see positive tendency of their general increase. Thus, only after 2 years after official launch of the CU in January 2010 the situation has substantially improved. Compared to 2009, the amount of total investment inflows in 2011 doubled while the amount of FDI almost tripled. That clearly proves positive effects of Belarus' membership in the CU on its attractiveness on the market of foreign investments.

As can be traced from Graph 6, the real sector of Belarus' economy (excluding banks) in 2013 received 14,97 bn USD of gross foreign investments, including 11,1 bn USD of FDI (74 % of the total); 0,12 bn USD of portfolio investments and 3,9 bn USD of others⁸⁰. High share of FDI in total foreign investments tells us about willingness of foreign companies to start their businesses in Belarus and its relative attractiveness for potential creditors compared to other countries in the region.

If we compare this indicator with Belarus' geographic CU neighbor – Russia, we can distinctly see Belarus' superiority in this aspect. Even though Russia has recently experienced steady growth of its foreign investment inflows which reached 170,18 bn USD in 2013, the share of FDI was significantly lower than in Belarus – only 15,3 %. Literally it means that foreign capital in Russia is concentrated in more passive types of investment, such as portfolio investments (e.g. stocks or bonds) or other kinds of investments like trade credits, credits from international financial organizations and bank deposits of foreign companies in Russia. The share of the second group (other investments) is actually leading in the structure of Russia' foreign investments inflows and amounts to 84 % with a tendency for growth. Taking into consideration that this group of investments represent

⁸⁰ Ministry of Economy of the Republic of Belarus [on-line]. [cit. 2014-2-12]. Available from WWW: <http://www.economy.gov.by/ru/invpolicy/invest-klimat/pezzultat>

low-term money that can quickly withdraw from the country's economy in case of any recession or crisis, the negative impact on the stability of the development of Russian economy is clear.⁸¹

As regards geographical origin of FDI inflows to Belarus, the absolute leader in 2013 was Russia – 52,5 % of total value. On the one hand, this figure reflects traditionally close economic ties between two countries; but on the other hand, could represent preference of Russian investors to allocate their funds in Belarus which, as comes from Table 17, has relatively better business climate. The second and third positions in FDIs to Belarus were held by the UK (25,3 %) and Cyprus (6,8 %) – the countries that are traditionally associated with high concentration of Russian capital.

The World Bank experts in their turn believe that Russia is currently experiencing an economic downturn. Insufficient attention to the full implementation of comprehensive structural reforms led to a weakened business and consumer confidence. The negative forecast for the development of Russian economy were strengthened by unstable geopolitical situation in Eastern Europe (political crisis in Ukraine and Russian military aggression in Crimea). The new forecasts suppose that Russian GDP will grow only by 1,1 % in case the situation in Ukraine is resolved peacefully. If the situation continues to worsen Russia's economy in 2014 will decline by about 1,8% and capital outflow will increase by 2,4 times. As far as the outflow of foreign capital from Russia in the first quarter of 2014 already amounted to 70 bn USD⁸² and the political crisis in Ukraine by the end of April 2014 seems to be only deepening, we can suppose that outflow of foreign capital from Russian will continue that can cause its partial reallocation to Belarus.

5.4. Effects of the CU on Belarus' state budget

As it was mentioned earlier, the CU member countries agreed on the mechanism of distribution of import customs duties, according to which Belarus would obtain 4,70 %, Kazakhstan – 7,33 % and Russia – 87,97 % of the total sum of customs duties. However, it is worth giving a deep look at the implication of Belarus' participation in the Customs Union on state budget in order to identify possible sources of losses and gains. According

⁸¹ Newspaper "Vyedomosti". [on-line]. [cit. 2014-2-14]. Available from WWW:

<http://www.vedomosti.ru/finance/news/23426311/rosstat-pryamye-inostrannye-investicii-v-rossiyu-v-2013-g>

⁸² Business news portal "DP.ru". [on-line]. [cit. 2014-2-19]. Available from WWW:

http://www.dp.ru/a/2014/03/24/Minjekonomrazvitiya_ottok/

to calculations conducted by Center for Social and Economic Research in 2010⁸³ the main losses of state budget, if revenues from customs duties came to the national budget as before, would arise due to the sharp decrease in customs duty revenues on commodity group 8703 “Motor cars and other motor vehicles principally designed for the transport” owing to adjustment of the import tariff rate for Russia’s level. Thus budget revenues from customs duties on cars would be reduced by 7 times. According to calculation in total budget would lose 21,8 % of budget revenues obtained in 2008 from customs duties.⁸⁴

However, as it was noted in the research, Belarusian budget could also grow from its participation in the Customs Union, as part of the revenues from customs clearance of imported goods come to the national budget directly without distribution among other member countries. Thus according to experts’ estimations, 40 % of Russian imports would go through customs clearance in Belarus, and consequently customs charges would be transferred to Belarusian budget. In such case this sum would surpass the losses of state budget that were obtained from illustrative estimation of the impact of Belarus’ membership in the CU on state budget revenues (see previous paragraph).

As it was later shown by reality, the estimation was right. According to official statistics, with the general tendency of annually growing Belarusian budget the share of profits from the customs clearance was increasing too. Thus, when their share in 2009 was only 27 % of all budget inflows than the next year after implementation of SCT this figure already grew at 42 %. Generally, since 2000 the inflows to Belarus’ state budget from the customs clearance have been growing mainly due growing demand on imports from the EU on CU market and thus growth of transit through Belarusian territory. Thereof, we can conclude that Belarus’ accession to the Customs Union had positive effect on Belarus’ state budget and significantly contributed to its growth.⁸⁵

⁸³ CASE – Center for Social and Economic Research, Warsaw, 2010. [on-line]. [cit. 2014-2-23]. Available from WWW: http://www.case-research.eu/sites/default/files/publications/32701553_CNSA_405_0.pdf

⁸⁴ Customs duties for legal entities were increased from January 1, 2010, for individuals they were harmonized with Russian external tariffs on July 1, 2010. Russian import tariffs being 5-10 times higher than Belarussian ones were virtually prohibitive.

⁸⁵ News portal “BelTA”. [on-line]. [cit. 2014-2-21]. Available from WWW: http://www.dp.ru/a/2014/03/24/Minjekonomrazvitija_ottok/http://www.belta.by/ru/all_news/economics/Nalogovyje-postuplenija-v-bjudzhet-Belarusi-za-2013-god-vyrosli-na-11-do-Br1339-trln_i_659292.html

5.5. Effects of Russia's entry to the WTO on Belarusian economy

Russia has been a member of the World Trade Organization (WTO) since August 2012. Kazakhstan intends to join the WTO before January 1, 2015, i.e. before the full transition mode of operation within the Eurasian Economic Union. In such conditions, it is quite an important question whether Belarusian economy will be able to continue to compete successfully with its partners in the Customs Union that already due to negotiations with the WTO had to make a number of economic reforms, which substantially liberalized their markets and increased the overall competitiveness of their business actors on the international level. From another point of view, as a member of the Customs Union, Belarus is already forced to follow Russia in its fulfillment of certain conditions within the WTO, but cannot use benefits WTO member.

Preconditions of Belarus' vulnerability to market liberalization caused by Russia' entry to the WTO

It is worth noticing that almost all consequences that Russia faces after joining the WTO must be projected on Belarusian economy with regard to its participation in the CU and the importance of Russian market for Belarusian industry. In addition, the effects of some factors may make Belarusian economy even more vulnerable than Russian.

One of these factors is the fact that Belarus' economy is much more based on manufacturing compared with Russia and Kazakhstan which have extensive extracting industries (see Table 18). As shows the experience of other countries that entered the WTO, less industrialized economies are going through this process easier.

Table 182: Share of manufacturing in the economies of the CU member states in 2012

Country	Belarus	Russia	Kazakhstan
Share of employees in the manufacturing sector in the total number of labor force, 2012	47,2 %	36 %	37,9 %
Share of employees in the manufacturing sector in the total number of labor force	45,9 %	27,4 %	11,9 %

Source: CIA Factbook.

The situation is also complicated by the fact that Russia became a member of the WTO on terms which assume a relatively small number of tools to protect its market against imports. For example, when Brazil joined the WTO in 1996 the level of its bound

tariffs was around 30 %, while Russia's – only 7 %. Practically, this means that Belarus as a member of the CU is able to rely solely on the size of Russian bound tariffs.

Another major problem is a substantial lag of Belarusian economy expressed in lack of market reforms and high presence of government sector which mean increased burden on the state budget for a transitional period of adaptation to the WTO conditions. In this situation, the substantial cost of improving the competitiveness of the national economy bears state: modernization of enterprises, retraining employees, finding new markets etc. Previously in relation to forthcoming accession of Russia to the WTO and expected reduction of competitiveness of Belarusian products on CU market, the government of Belarus announced a policy of economic modernization. *“Year 2010 is a beginning of a radical restructuring and modernization of the economy. Overall objectives should be to achieve a surplus in foreign trade, reject unjustified imports and increase exports potential”*⁸⁶, – reported that day chief of the National Bank of Belarus Piotr Prokopovich after meeting with the President. The realization of planned modernization of public enterprises has not been very successful though as none of these objectives was reached, as we could see later. It was also admitted by already mentioned Piotr Prokopovich by the end of 2013 when he occupied the position of the Prime Minister of Belarus. He told that *“modernization is insufficient and do not correspond with possibilities and reserves of the country and...less than half of enterprises are modernizing well (40 %) while the rest – no”*⁸⁷. The reasons for failed modernization are dominantly its close economic directivity and unwillingness of the government to implement radical reforms aiming at the liberalization of economy; disengagement and inefficiency of the main implementers of changes – mostly bureaucracy and corporate governance; weak coordination of joint activities and low qualification of the state apparatus, especially in sphere of crisis management and reforming the economy in conditions of a market economy. As we can see, the main factor impeding such necessary modernization is institutional. This inclines me personally to the opinion that economic transformation of Belarus is virtually impossible without a radical political transformation and fundamental changes in Belarusian society.

⁸⁶ News portal “tut.by”. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://news.tut.by/economics/337167.html>

⁸⁷ News portal “naviny.by”. [on-line]. [cit. 2014-2-23]. Available from WWW: http://naviny.by/rubrics/economic/2013/12/20/ic_news_113_429935/

In addition, one more negative factor was the absolute unpreparedness of Belarusian government to the consequences of Russia's accession to the WTO, despite the fact that it was known in advance. Subsequently, not all the risks and threats were calculated and almost no necessary measures to mitigate the effects of Russia's accession to the WTO for Belarusian economy were adopted. A striking example can be the Treaty on the functioning of the Customs Union within the framework of the multilateral trading system signed in May 19, 2011 and consequently ratified on November 4 of the same year. The aim of the contract was to ensure full operation of the Customs Union in the event of accession of one or more of its members to the WTO. The total shortsightedness and imprudence of Belarusian government shows the fact that only after ratification of mentioned agreement by Belarusian parliament, the Deputy Foreign Minister Alexander Guryanov sent to that time Deputy Prime Minister Sergej Rumas a letter proposing to analyze what exact impact on Belarusian economy would have Russia's accession to the WTO⁸⁸.

Another important disadvantage are geographically weakly diversified sales channels for Belarusian products – mainly with its eastern partners (Russia and other post-Soviet countries) as trade with the west (EU) is complicated by difficult political relations, sanctions and other economic disadvantages such as high protectionist measures (especially for food products) and incomparable competitiveness (for example for machinery and vehicles) of inner market. Due to geographical limitations of distribution networks Belarusian producers are constantly forced to seek for new developing markets and non-standard ways of sales promotion, such as preferential terms of payment to customers. For example, a quite serious burden is laid upon Belarus' budget by practice of offering preferential loans to buyers of engineering products in CIS countries. For Belarus this procedure involves transfer of funds to offset the interest on the loans. To date, the list of Belarusian companies covered by the possibility of preferential supply of loans exceeds 30⁸⁹. If Belarusian government wants to increase the demand for products of Belarusian engineering it has to expand a lending program that will definitely increase government spending. This step in terms of permanent budget deficit and a negative balance of trade will even worsen the situation of Belarusian economy.

⁸⁸ News portal "naviny.by". [on-line]. [cit. 2014-2-2]. Available from WWW: http://naviny.by/rubrics/economic/2012/08/28/ic_articles_113_178990/

⁸⁹ Official dealer of Minsk Automobile Plant (MAZ) in Russia. [on-line]. [cit. 2014-1-13]. Available from WWW: <http://www.maz-gruzovik.ru/news/lgotnye-kredity-na-pokupku-produkcii?offset=160>

Decline of demand for Belarusian goods on Russian market

The Customs Union primarily expected to provide deeper economic integration and create positive effects on the GDP growth of its member states by rising sectorial output and increasing trade flows between the countries. Meanwhile short-term positive effects that Belarus experienced in the first years of integration have been almost totally overshadowed by consequences of Russia's membership in the WTO that made Belarusian goods de facto compete with many foreign competitors. Since Belarus accepted Russia's commitments on market access for goods coming from the WTO countries, certain "compulsory trade liberalization" has occurred. It caused a drop in Belarus' exports as competitiveness on CU market increased. Thus, e.g., the decrease of demand for Belarusian goods on Russian market resulted in more than 6 % decline of Russia's share in Belarus' exports in 2013. The heaviest losses experienced machinery and vehicles – the product group that traditionally composed about 40 % of Belarus' exports to Russia. Russia at the same time was the main market for these goods providing 70-80 % of total sales.

Even though the first years after Belarus' accession to the Customs Union were really trade generating and participated, the next years were characterized by GDP' slump in 2012 that passed into economic stagnation which is continuing till now. Thus, only in January-February 2014 the GDP of Belarus decreased by 1,6 % comparing to the same period of previous year⁹⁰. The most significant decrease, as we can guess, was in industrial output (5,5 %) – the goods that are traditionally exported to Russia. The 4 % slump was even in the sector of agricultural production which had been significantly growing in the recent years. That could be explained by both increased competition and general shrinkage of demand on Russian market due to Russia' economic recession. The difficulties that have faced Belarussian products in Russia since 2012 were also admitted by high Belarusian officials. In May 2013 Belarusian Deputy Prime Minister Semashka publicly bemoaned the consequences of Russia's membership of the WTO: *"Belarusian industry is still not fulfilling forecasted figures... First, there are effects of global recession. Secondly, from January 1, Russia joined the WTO and Russian market for us is one of the most important,*

⁹⁰ News portal Naviny.by [on-line]. [cit. 2014-2-26]. Available from WWW: http://naviny.by/rubrics/economic/2014/03/20/ic_news_113_433706/

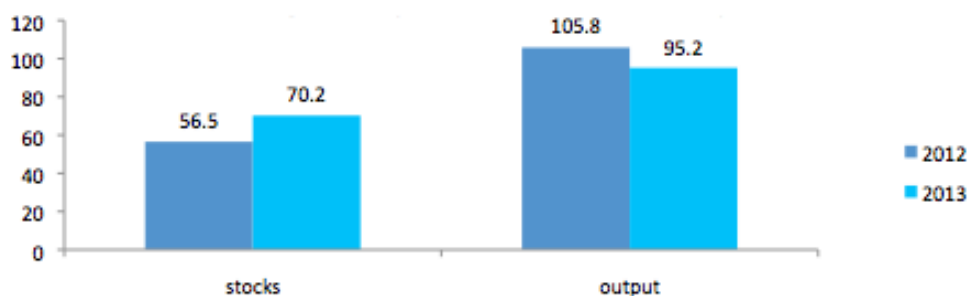
especially with regard to engineering products. And we have already fully sipped negative moments of being in fact in the WTO, since we are members of the Customs Union."⁹¹

Hence, we can conclude that negative effects that experienced Belarus' trade after Russia's accession to the WTO have recently exceeded the positive ones that were connected to mutual trade growth inside the union. In order to overcome them Belarus should promptly increase its external competitiveness either by vast modernization of its economy or by acceleration of its negotiations about entering the WTO. Both of these scenarios, as we already mentioned, do not seem to be realistic in the nearest future. Thus, it leaves the prospective development of Belarusian exports and economy quite unclear.

Growing stocks of finished goods

The decline of Belarus' foreign competitiveness on CU market due to Russia's accession to the WTO in 2012 caused decline of sales of Belarusian products on the CU market and thus triggered large-scale rise of stocks in Belarusian storehouses. Currently this problem remains one of the main issues of Belarusian economy. Even when in 2013 the volumes of production were generally decreasing the stocks of finished goods still exceeded norms.

Graph 7: Output (% growth to the previous year) and stocks of unfinished goods (as % of average industrial output) in Belarus, 2012-2013



Source: Analytic portal "Belarus Digest" [on-line]. [cit. 2014-2-26]. Available from WWW:

<http://belarusdigest.com/story/strict-monetary-policy-solve-economic-problems-belarus-economy-digest-17031>

During 2013 Belarusian industrial output fell by 4,8 % while amount of stocks against the average monthly production volume amounted to 70,2 % which was almost 15 percent point more than in 2012 (see Graph 7). In accordance with officially predicted

⁹¹ News portal "naviny.by". [on-line]. [cit. 2014-2-23]. Available from WWW: http://naviny.by/rubrics/economic/2013/05/27/ic_news_113_417614/

figures, stocks were not to exceed 65 % of the monthly production volume until the end of the year. However, this forecast did not appear to be true and resulted in the fact that several industries (textiles and clothing production, leather production, production of machinery and equipment) built up substantial stockpiles of their goods and were unable to sell them on the CU market.

The most acute problems were faced by producers in light industry which participate don 7,3 % of Belarusian exports to Russia in 2012 (for more, see 4.4. Belarus-Russia). For example, according to the National Statistic Committee of the Republic of Belarus, stocks of footwear and leather products accumulated in warehouses in 2013, were on average 2,6 times higher than the monthly production, stocks of textile products exceeded the volume of domestic production by 1,75 times. This indicates the showed up inability of Belarusian goods to compete with their cheap foreign substitutes, especially from China and South-Eastern Asia. Similarly sad situation experienced producers of strong alcohol when, e.g., the average monthly storage of Belarusian vodka in 2013 was about 182 % of its monthly production.⁹².

The position of Belarusian producers in the field of heavy industry that supply about 40 % of total value of Belarusian exports to Russia, however, is not much easier. According to official statistics, the sales of Belarusian heavy trucks and vehicles in Russia during 2013 declined on average by 28,7 %⁹³. Except losing its competitiveness due to Russia's membership in the WTO there is a clear trend of decreasing interest of Russian buyers in relatively expensive trucks and buses made in Belarus. Even being 20-30 % cheaper than their western competitors Belarusian vehicles already cannot boast same quality and characteristics without major modernization of the production. In addition, the situation is getting harder due to growing competition with Russian producers that are actively developing assembling of foreign brands. Since 2009 several factories for the production of dump trucks have been launched: Volvo (production capacity of 10 000 cars/year by 2015) and Renault (5 000 cars/year) in 2009; Scania (5 000 cars/year) and Mercedes-Benz (4 500 cars/year) in 2010, MAN (6 000 cars/year) in 2013. It looks like Russian government made an excellent plan how to regain its own trucks market and make Belarusian counterpart lose its former competitive advantage in Russia. Meanwhile,

⁹² Newspaper "Pravda" [on-line]. [cit. 2014-2-23]. Available from WWW: <http://www.pravda.ru/economics/rules/globalcooperation/17-05-2013/1156609-belorussia-0/>

⁹³ News portal "Chartya97" [on-line]. [cit. 2014-2-23]. Available from WWW: <https://charter97.org/ru/news/2014/3/26/91938/>

Russian car industry has gained financial support from the state in order to lighten the effects of the recycling tax that Russia had to apply due to new WTO requirements from March 1, 2014. As follows from the conditions of the tax, the price of Belarusian heavy vehicles increased by about 4-11 thousand USD hence raising their price by 10-40 %. Therefore, the prices of Belarusian trucks got higher that finally led to even bigger decline of their competitiveness on Russian market.⁹⁴

At the moment the economic forecast for Belarus is almost the worst for the last 15 years. In 2013 difficulties in production and sale of Belarusian products, both on domestic and foreign markets, led to deterioration in the performance of almost all industries. Revenue growth and profit margins of enterprises witnessed steady declines and the total number of unprofitable enterprises increased. According to official statistics⁹⁵, more than half of all enterprises in the country were unprofitable or marginally profitable in 2013. So, from 8232 organizations, whose results were taken into account in 2013, 1154 organizations were unprofitable and 3268 – marginally profitable (with profit margin of up to 5 %). Compared with 2012, the number of unprofitable enterprises has increased by half.

Poorness trap and outflow of qualified labor

During the last decade Belarus benefited largely from the open Russian labor market, as Belarusian economy produced few new jobs while its labor force was growing. Since the mid-90s Belarus has enjoyed a so-called demographic benefit that was caused by a steep decrease in fertility in the early 90s and a change in the age structure accompanying it. Starting from 1994, the working age population was rising and the demographic burden was steadily declining up to 2008. Since then however, the picture has reversed, and a decrease in the labor force followed making the demographic burden heavier. This trend has already created a deficit in some specialties in Belarusian labor market, from construction to medicine. Taking into account that the gap between Belarusian and Russian wages is widening and the demographic situation in Belarus is steadily getting worse, further shortages in a number of specialties in Belarusian labor market are inevitable.⁹⁶

⁹⁴ Newspaper “Pravda” [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://www.pravda.ru/economics/rules/globalcooperation/17-05-2013/1156609-belorussia-0/>

⁹⁵ News portal “Naviny.by” [on-line]. [cit. 2014-3-23]. Available from WWW:

http://naviny.by/rubrics/opinion/2014/02/17/ic_articles_113_184614/print/

⁹⁶ Eastern Europe Studies Centre. *Will the Eurasian union determine the future of Belarus?* [on-line]. [cit. 2014-2-23]. Available from WWW: [http://www.eesc.lt/uploads/news/id505/Bell_2013_5\(35\)n.pdf](http://www.eesc.lt/uploads/news/id505/Bell_2013_5(35)n.pdf)

However, the income gap between Belarus and neighbor countries is unfortunately not changing. According to experts⁹⁷, the situation in the real sector severely limits the growth of Belarusian economy. Thus, by the end of 2014 as per official plans the economy of Belarus will grow by 3,3 % (compared with 8,5 % forecast for 2013) while the IMF's assessments are even more modest – only 1,5-2,4 % growth. Anyway, these rates are not satisfactory and if Belarus wants to ensure the welfare of the population at least similar to its neighbors, Poland or even Russia, it is necessary to grow more rapidly.

In the long run this situation can cause a so-called poverty trap. It is expressed in the fact that due to low rates of economic growth it is quite problematic to raise real payments while freezing of payments at current levels can lead to significant outflow of Belarusian labor force abroad. Statistically, many of them are skilled professionals, graduates and entrepreneurs that due to unfavorable business conditions in Belarus⁹⁸ prefer to register their companies abroad. The free movement of labor inside the Customs Union facilitates this tendency. Thus, according to estimates of the Ministry of Labor and Social Defense nowadays about 100 000 Belarusians work in Russia, unofficial version is even bigger – 1 mio people⁹⁹. All this finally leads to a brain drain and significant decrease of Belarus' human potential.

In 2013 in order to prevent mass outflow of personnel Belarusian enterprises had to increase wages at faster pace than dynamics of productivity growth. According to the Ministry of Economy the rate of real wages growth in Belarus in January-September 2013 passed ahead of the productivity growth rate by 16,4 percent points. This tendency had its negative effects on profitability of business entities, slowing down of expanded reproduction and reduction of possibilities for capital accumulation. Consequently it participated on decline of competitiveness of Belarusian companies on foreign markets.¹⁰⁰

However, this situation cannot exist forever. Apparently, there is no reason to expect economic modernization that can solely cause substantial growth in the productive

⁹⁷ News portal "Naviny.by". [on-line]. [cit. 2014-3-23]. Available from WWW: http://naviny.by/rubrics/opinion/2014/02/17/ic_articles_113_184614/print/

⁹⁸ The worst situation is in the sphere of paying taxes. As per the Doing Business Index measured by the World Bank, Belarus was on 133d position out of 183 countries in 2013. According to specialists, high level of taxation and formal procedures that got even more complicated after the country entered the EurAsEC Customs Union, make existence of Belarusian SMEs almost unprofitable.

⁹⁹ News portal "Товарищ.online". [on-line]. [cit. 2014-2-23]. Available from WWW: <http://www.camarade.biz/node/6127>

¹⁰⁰ Scientific magazine "SCI-ARTICLE.RU" [on-line]. [cit. 2014-2-23]. Available from WWW: http://sci-article.ru/stat.php?i=sootnoShenie_tempa_rosta_proizvoditelnosti_truda_i_zarabotnoy_platY_v_otrasli_pro_mYShlennosti_respubliki_bielarus

of labor in Belarus in the nearest future. Firstly, the stagnating Belarusian economy simply has no funds for it. Secondly, and what is even more important, there is no political will to implement drastic measures and economic reforms that are currently so necessary for Belarus' economy¹⁰¹. Without these reforms though, there is no hope to get any loan from international financial institutions. The only possibility to get necessary funds for modernization is to get credit from Russia which in its turns requires further privatization of key state-owned enterprises for benefit of Russian investors. This, however, causes even bigger economic dependence of Belarus from its big eastern neighbor.

Therefore, as turned out, the imbalance between real salaries and labor productivity has no real economic grounds and will finally have to cease in the nearest future. Consequently it will cause the decrease of payments, thus further deepening the brain drain and real unemployment in Belarus. Nevertheless the official unemployment is still below 1 %, some analysts suppose that the real figure is about 40 times higher and may increase to 30 % by the end of 2014. The reason for this dramatic situation is already clear – massive outflow of qualified labor due to ongoing economic crisis¹⁰².

Conclusions. Summing up the information and facts about impacts of Russia' WTO membership on Belarusian economy, we should conclude that most of Belarusian producers were not prepared for changing conditions on CU market. That reflected in significant decline in the share of Belarusian products on CU market. It seems that in the coming years due Russia' liabilities to the WTO (reduction of import duties and further abolition of protective measures) this tendency will only deepen.

It is unlikely that Belarusian government will solve this problem by market methods, such as decrease in public jobs, revision of industrial policy, reduction of government intervention in the economy or massive privatization. The reason is simple: such actions could have a negative impact on the extent of national elite's political power. In addition, market solutions mean loss of control levers for industry.

¹⁰¹ News portal "Belarus in Focus". [on-line]. [cit. 2014-2-23]. Available from WWW: <http://belarusinfofocus.info/p/6082>

¹⁰² Agency of Financial News (AFN). [on-line]. [cit. 2014-2-23]. Available from WWW: <http://afn.by/news/i/169226>

Most likely in order to maintain its current position with regard to the importance of Russian market Belarusian authorities will continue to use old methods: extension of a preferential lending and direct agreements with Russian side.

6. Problems of Belarus' economy and foreign trade

The following part is based on previously analyzed statistical data and summarizes main challenges that are faced by Belarus's economy and foreign trade that are in one way or another connected to its membership in the CU.

6.2. Decline of Belarus' competitiveness on foreign markets

According to the World Bank special report from March 2014¹⁰³, nevertheless Belarus' trade performance was dynamic over the past decade, external vulnerabilities have also intensified thus reflecting its declining competitiveness. Thus, according to the estimation made by the SIC Mises and Analytical Center "Strategy"¹⁰⁴ the possible place for Belarus in the Global Competitiveness Index¹⁰⁵ 2010-2011 would be only 87th (out of 139 countries). Compared to Belarus, its neighbor countries had relatively better positions: Poland – 41st, Lithuania – 44th, Latvia – 64th, Russia – 66th, Ukraine – 82th.

As a small export-oriented economy, economic development of Belarus is linked to its ability to produce and sell goods and services competitively in the global market. In recent years, weak export performance has been a source of major external imbalances. While deterioration of trade balance was exacerbated by a feeble global economy; there is an underlying, longer-term trend of declining competitiveness. Russia's accession to the WTO in 2012 has added to competitive pressures in the Customs Union, threatening additional loss of market share for Belarusian exporters. Russia and other CIS countries have always been traditional export destinations for Belarusian goods. Therefore, when the country faced need to compete on its usual markets with new world players, all the

¹⁰³ The World Bank. [on-line]. [cit. 2014-2-23]. Available from WWW: <http://www.worldbank.org/content/dam/Worldbank/document/eca/belarus/Belarus-Economic-Update-Focus-mar2014-en.pdf>

¹⁰⁴ IT Consulting and Innovative IT Outsourcing company "Business Data Processing Limited". [on-line]. [cit. 2014-2-23]. Available from WWW: <http://businessdataprocessing.com/international-rating-for-belarus-2012/>

¹⁰⁵ The Global Competitiveness Report (GCR) is a yearly report published by the World Economic Forum. Since 2004, the Global Competitiveness Report ranks countries based on the Global Competitiveness Index that measures the set of institutions, policies, and factors that set the sustainable current and medium-term levels of economic prosperity.

economic indicators of the state sank sharply. Belarusian products, unfortunately, were not ready for this competition.

The situation though can be improved by finding new developing markets and giving more freedom of actions to enterprises in order to quicker adapt to the changing situation and efficiently react on the problems emerging on foreign markets. However, these requirements are not so easy to meet. On the one hand, the country due to its low competitiveness has not yet managed to find partners who would benefit from close economic cooperation with Belarus. On another hand, the planned nature of Belarusian economy leaves almost no chances to its producers (about 80 % of them are state-owned). The problem of overloaded warehouses is therefore partly a consequence of Belarusian economic model which focuses more on gross production, which depends not on demand on specific markets but on the plan adopted by the government.

Improved competitiveness for Belarusian manufactured goods, as well as the strengthening of foreign trade relations will foster normalization of the situation in the real sector. The unloading of stocks and increase of sales will contribute to the improvement of the country's trade balance. But in order to maintain its competitiveness in capital intensive heavy machinery and chemical industries, Belarus requires ensuring on-going modernization and hence stable levels of capital investments. Both internal as well as foreign direct investments are viable alternatives to consider. Furthermore, it is crucial for the country to reduce the inherent volatility of its development; therefore it needs to continuously work on increasing the breadth of its foreign trade relations¹⁰⁶

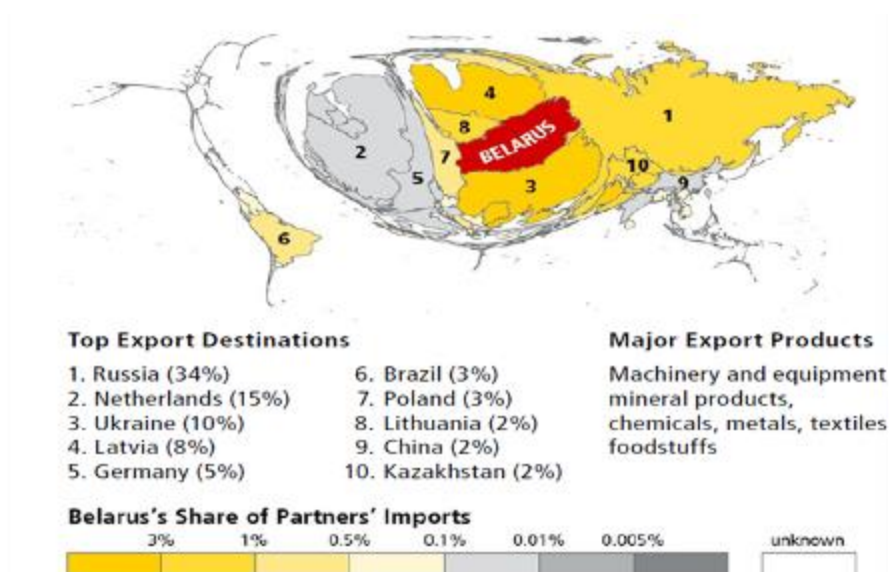
6.3. Narrowing of the breadth of Belarusian foreign trade

Foreign trade is vital for Belarus' economy and traditionally generates about half of its GDP. Despite substantial world market shares in some products like potash fertilizers or mining dump trucks, Belarusian trade has very strong regional focus. USSR heritage results in developed heavy machinery industry, but also in very high dependence on imports, especially minerals necessary for development of its machinery and petrochemical industries. It can be seen, e.g., from traditionally high percentage (50-60 %) of imports

¹⁰⁶ Analytic portal "Belarus Project". [on-line]. [cit. 2014-2-23]. Available from WWW: http://belarus-project.eu/2013/01/belarusian_foreign_trade/#_ftn2

from Russia which are mostly minerals. This aspect is one of the reasons why Belarus' has traditionally had low characteristics of breadth of trade. Thus, according to DHL Global Connectedness Index, Belarus has one of the most regionally concentrated trade structures in the world which resulted in its 117th position out of 140 countries in breadth of trade in 2011. The figure indicates strong focus of Belarus' foreign trade on limited number of countries and critically narrow breadth of its trade connections. Picture 5 illustrates the destinations of Belarusian exports (countries are sized in proportion of their share in Belarus' exports and are colored in proportion of Belarus' share in their imports).

Picture 13: Belarus' merchandise exports, 2011



Source: DHL Global Connectedness Index. [on-line]. [cit. 2014-3-23]. Available from WWW:

<http://www.dhl.com/content/dam/flash/g0/gci/download/BLR.pdf>

The process of narrowing the breadth of Belarus' foreign trade is not only a matter of nowadays but has already had place at least for last decade and intensified after Belarus entered the Customs Union in 2010. According to the data from the DHL Global Connectedness Index¹⁰⁷, since 2005 Belarus has come down by 13 positions in breadth of foreign trade and occupied 117th place among 140 observed countries in 2011. The share of trade on the same continent in 2011 amounted to 85 % while in 2005 it was only 35 %. Thereof, we can notice that Belarus' foreign trade policy is continuously inclining towards concentration on Eurasian post-Soviet markets (especially Russian) at the expense of other countries. From this reorientation especially suffers trade with the EU – the market that until 2013 unlike other trade partners had generated positive trade balance for Belarus. As

¹⁰⁷ The last released report: DHL Global Connectedness Index. [on-line]. [cit. 2014-3-23]. Available from WWW: <http://www.dhl.com/content/dam/flash/g0/gci/download/BLR.pdf>

could be clearly seen before from Table 19 the share of Belarus' exports to the EU has been continuously falling from 29,5 % in 2008 to 21,0 % in 2012. The same tendency is observed by imports from the EU. It finally led to the shrinkage of the EU-Belarus turnover for more than 7 % during 4 years since 2008. At the same time the importance of Russian market for Belarussian goods has been growing steadily. Thus, Russian share in Belarusian exports increased for about 13 % from 2008 till 2013 while Russia steadily maintained about half of Belarus turnover since Belarus got its independence in 1990. It is a clear sign of Belarus' continuous trade dependence on Russia and regime's politic and economic narrow-mindedness. Instead of trade diversification, the government has been continuously intensifying economic relations with its eastern partners that concluded with Belarus' entrance to the Customs Union (for more, see **Chyba! Nenalezen zdroj odkazů**.2. Effects of the CU on Belarus' foreign trade flows).

Table 19: Shares of Belarus' partners in it foreign trade turnover (% of total)

Year	2008	2009	2010	2011	2012	2013
With Russia	47,3	47,0	46,6	45,2	47,4	49,5
- Exports	32,4	31,5	39,4	35,0	35,4	45,2
- Imports	59,7	58,5	51,8	54,5	59,4	53,2
With Kazakhstan	0,7	0,8	1,4	0,9	1,0	1,2
- Exports	1,1	1,5	1,8	1,6	1,8	2,3
- Imports	0,4	0,3	1,2	0,3	0,3	0,2
With other countries of the CIS	8,0	7,4	8,8	9,4	9,8	9,4
- Exports	10,6	10,7	12,7	12,5 %	14,3	14,3
- Imports	5,8	5,0	5,9	6,6	5,3	5,2
With the EU	23,1	20,6	19,6	17,7	16,5	-
- Exports	29,5	31,7	33,4	23,3	21,0	-
- Imports	17,8	12,3	9,6	12,6	12,1	-
With the rest of the world	20,9	24,2	23,6	26,7	25,2	-
- Exports	26,4	24,6	12,7	27,5	27,5	-
- Imports	16,3	23,9	31,5	26,0	22,9	-

Source: National Statistical Committee of the Republic of Belarus. Own calculations.

6.4. Dependence on oil-processing industry vs. Energy dependence from Russia

Currently Russia is the only foreign supplier of energy resources (oil, natural gas, electricity) which Belarus according to annual bilateral agreements receives at inner Russian prices. At the same time, fuels and petroleum products produced from Russian oil comprise about third part of Belarus' total exports while their share in exports to Ukraine and the EU exceeds 50 %. During last 20 years oil-refining business became a hallmark of Belarussian industry and the biggest generator of positive trade balance for the country. The

competitiveness of the rest of Belarus' exports is also dependent on supplies of energy resources, as Russia's oil and natural gas subsidies make Belarusian goods cheaper through lowered production costs.

Thus, according to the rating compiled by Bloomberg financial agency, Belarus is among the three countries whose economies are most dependent on oil¹⁰⁸. The data were obtained by analyzing the proportion of the oil component in the GDP in the period from 1993 to 2018. The projected figures of the International Monetary Fund were also used. All together the rating takes into consideration 15 states, including oil-producing countries with production volumes significantly exceeding Belarus.

The reason for insertion of Belarus to the rating is its actively developing petrochemical industry. Thus, according to the rating, in 2018 the share of revenues from oil refining in Belarus will amount to 13,9 % of GDP and can reach 12,8 bn USD. It is noteworthy that in 1993 the export of oil products from Belarus in general was zero.

The downside of such bright prospects is almost complete dependence of Belarus on oil supplies from Russia (Belarus covers only 10 % of its oil consumption from own reserves). All impressive numbers from the export of petroleum products currently depend on several factors. The first is negotiated "subsidized" price per ton of oil which for the period January-November 2013 was only 391 USD compared to world price of 766 USD per ton.¹⁰⁹ The second are Russia's harsh policies during preparation of contracts for oil supplies to Belarus. Generally it is built on a commitment from Belarusian side of the forced privatization in favor of Russia and reciprocal exports of already refined oil back to Russia at significantly reduced prices.

Taking into account increasing binding of Belarusian economy to its oil refining industry, we can say that Belarus' prospects to become fully dependent on Russia in this matter only grow.

However, Belarus' dependence on Russia in the oil industry remains less significant than in case of natural gas. Thus, while Belarusian state still has majority stakes in both of its oil refineries (in Navapolatsk and Mazyr) the whole gas infrastructure belongs predominantly to Russia. Belarus' dramatic energy dependence on Russia becomes clear with the fact that almost all energy (95 %) consumed by the country is produced on

¹⁰⁸ Bloomberg L.P. [on-line]. [cit. 2014-2-9]. Available from WWW: <http://www.bloomberg.com/visual-data/best-and-worst/most-oil-dependent-economies-countries>

¹⁰⁹ "Minsk Union of Entrepreneurs and Employers". [on-line]. [cit. 2014-2-9]. Available from WWW: <http://allminsk.biz/content/blogsection/12/84/9/945/>

thermal power plants where share of Russian natural gas accounts to about 85 %.¹¹⁰ Nevertheless the county has several hydro and wind power stations, their potential to provide energy security for Belarus are insignificant. Construction of Astravets nuclear power plant¹¹¹ seems to be the only realistic idea for energy diversification even though it is supposed to cover only 30 % of Belarus's energy consumption after its launch in 2016-2020. Although nuclear energy looks economically beneficial, Russia's control over the project, combined with Belarus' doubtful ability to repay the accompanying 9 bn USD loan, raises many questions. This means that in this area Belarus' opportunities to achieve greater energy independence remain quite feeble due to political unwillingness of its authorities and their inability to attract foreign investors.¹¹²

Although state-owned Gazprom became a gas monopoly in Belarus, it is not pushing prices higher. Belarus receives natural gas cheaper than any other country in Europe. In 2014 Belarus will pay only 167 USD/thousand m³ which is an absolute minimum compared to its neighbors. For example, the price for Ukraine since April 2014 is 485 USD while Poland and Lithuania buy Russian gas for an average price of 500 USD/thousand m³.¹¹³ However, Russian benevolence does not seem to be groundless – every annual contract on energy resources is connected with some political challenges and concessions that Belarusian side is forced to do. As in the case of oil, Russia decides how much and at what price to deliver natural gas to Belarus depending on the state of their relations. All of this shows how Moscow uses Belarus' energy dependence to get what it wants.

However, Russia at present does not use its full control over Belarus' energy infrastructure for political or economic blackmail; but it remains possible in the future. It is clear that the Kremlin wants to achieve the same position in the oil industry in Belarus as it already has in gas –to take control of the entire infrastructure. Even though it is a rather straightforward position to hold, Russian side understands that for the moment only their

¹¹⁰ According to the National Statistical Committee of the Republic of Belarus.

¹¹¹ A multi-reactor nuclear power plant project in North-Western Belarus, Astravets district. The drive for the current project was fueled by the Russia-Belarus energy dispute in 2007 and the project foresees construction of two nuclear reactors between 2016 and 2020, and probably two more reactors by 2025.

¹¹² Expert society of Belarus "Nashe mneniye". [on-line]. [cit. 2014-2-3]. Available from WWW: <http://nmnby.eu/news/analytics/5441.html>

¹¹³ BBC news. [on-line]. [cit. 2014-2-7]. Available from WWW: http://www.bbc.co.uk/russian/business/2014/04/140403_russia_ukraine_gas_even_higher.shtml

energy shipments remain economically meaningful for Belarus¹¹⁴. Under the current conditions, Moscow can arbitrarily change the prices for both oil and natural gas, which could force some Belarusian enterprises to go bankrupt or perhaps even the whole country.¹¹⁵

6.5. Economic overdependence from Russia

As was already mentioned, Russia is the main trading partner of Belarus on both exports and imports (with about 53 % and 45 % shares in 2013 respectively). For Belarus' export-oriented economy (exports account approximately to half of its GDP) trade addition to Russia may become a great threat to its financial stability as the economic situation in Russia is quite unstable and greatly depends on the fluctuation of the world prices for mineral resources. If we look at the statistics of the development of the GDP in Russia and Belarus that are shown in the next table, we can see correlation and dependence of Belarus' growth on the state of Russian economy.

Table 20: GDP growth rate in Russia and Belarus, 2008-2013 (current prices, %)

Year	2008	2009	2010	2011	2012	2013
Russia	27,8	-26,3	21,1	27,4	34	1,3
Belarus	34,5	-19,1	12,2	16,3	-1,4	0,9

Source: the World Bank.

Another important fact is that Russian dependence on exports of mineral resources is developing with increasing tendency. If the share of oil and gas in its total exports amounted to 33 % in 1994, then by the end of 2013 this figure gradually increased at 60 %. Together with metals and other mineral resources this share grows at 70 %.¹¹⁶

Moreover, Minsk's dependence on Moscow is strengthened by Russia's position of a major investor and important player in the banking sector of Belarus. According to the

¹¹⁴ 2010-2012 were years of harsh politic confrontation with Russia when Belarus made several steps in order to show possibilities for its energy diversification and independence of its foreign policy. On the one side, it was negotiating with the EU that offered its technical assistance and investments for modernization of Belarus' energy sector in return for structural reforms and commitments for democratization. This price, however, appeared to be too high and met unwillingness of Belarusian authorities. On another side, Belarus in a pointed manner negotiated part of its oil imports from Venezuela. Even though it was not very economically feasible nor did make economic sense, it became a big politic challenge for Russia and gave Belarus additional advantage in bargaining the prices for energy resources and concessions for its producers in the Customs Union.

¹¹⁵ Analytic portal "Belarus Digest". [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://belarusdigest.com/story/belarus-russian-energy-needle-16594>

¹¹⁶ News portal "uainfo.org". [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://uainfo.org/heading/economics/print:page.1.88048-razgrom-mifa-o-ekonomicheskoy-prosvetanii-rossii-tolko-fakty-i-cifry.html>

National Statistical Committee of the Republic of Belarus, Russia remains its main investor, putting in about 50 % of the investments while United Kingdom and Cyprus occupy the second and the third place – the countries where Russian businessmen like to register their companies. According to Agata Wierzbowska-Miazga¹¹⁷ from the Centre for Eastern Studies in Warsaw, Russian banks have become the largest source of foreign currency loans for Belarusian companies. BPS-Sberbank, BelVEB, Belgazprombank belong to the largest commercial banks in Belarus. Russian businessmen in total control 7 out of 31 banks in Belarus.

In view of complications that have already arisen for Belarusian manufacturers on Russian market it is particularly important to maintain their products in the list of public procurement of Russian Federation. To date, Russian public procurement system includes Belarusian tractors, trucks, combines, refrigerators, transformers, elevators etc. It is reasonable that Russian government can use this opportunity as a lever to solve political and economic problems in its favor, particularly to push ahead the privatization process. An example might be the situation with possible sale of shares of Minsk wheeled tractor plant. Decommissioning of its products from Russian public procurement list and hence loss of a major source of sales was one of the decisive reasons for the privatization of the company in favor of Russia.

As far as Belarusian exports extensively depend on the level of foreign demand its prospects does not seem optimistic due to quite discreet perspectives for the development of Russian market that traditionally buys almost half of Belarusian products. Together with general economic recession the situation in 2014 is worsened by large-scale outflow of foreign capital caused by Russian military aggression to Ukraine (for more, see 5.3. Effects of the CU on Belarus' foreign investment inflows). The forecasts of the World Bank, e.g., suppose that Russian GDP will grow by 1,1 % in case the situation in Ukraine is resolved peacefully. If the situation continues to worsen Russia's economy in 2014 will decline by about 1,8% and capital outflow will increase by 2,4 times.

Thus, economic dependence of Belarus on Russia is so strong and ubiquitous that it seems unlikely that Minsk could start any conflict with the Kremlin or develop its sovereign foreign policy. However, the idea to diversify Belarusian exports is becoming

¹¹⁷ Center for Eastern Studies, Warsaw. *Support as a means of subordination: Russia's policy on Belarus*. [on-line]. [cit. 2014-4-12]. Available from WWW: http://www.osw.waw.pl/sites/default/files/pw_34_bialorus_ang_net.pdf

rather popular even among Belarusian officials. Belarusian diplomats are constantly trying to improve ties with developing countries that resulted in opening of 9 diplomatic missions in 2013. However, the problem of Belarus' foreign trade is not just one of a desire to diversify its markets, but also about possibilities to do so. Many Belarusian enterprises look too obsolete. If the authorities fail to carry out modernization and necessary economic regulations, they will soon convict a great part of the enterprises to stagnate and even go bankrupt.¹¹⁸

¹¹⁸ Analytic portal "Belarus Digest" [on-line]. [cit. 2014-2-3]. Available from WWW: <http://belarusdigest.com/story/belarus-and-russia-stagnating-together-16640>

7. Perspectives of Belarus' membership in the CU and future of its economy

It is important to point out that except enthusiastic praises from the officials of the three member states the Customs Union has also attracted criticism and skepticism from the outside world, especially from the EU, members of the WTO and from domestic producers and businessmen in Kazakhstan and Belarus particularly. All of them have tended towards seeing Eurasian integration as a way for Russia flexing its economic power in what it considers its “sphere of influence” and in more severe cases it has also been called a revival of the Soviet Union¹¹⁹.

Thus, this part will give in a more detailed outlook of the political ground of Eurasian integration and the consequences that it could bring for Belarusian economic and politic guidelines in the future. It will also give a prediction of Belarus' economic development in the nearest future and its possible politic behavior in the CU.

7.1. The question of political power and equality in adoption of solutions within the CU

Despite the fact that according to agreements on the formation of the common economic space of the CU in 2012 there should be absolute abolition of obstacles to free movement of goods, services, people and capital, these guaranteed freedoms are still not completely into force. This situation seems to be natural due to different political and economic strength of member countries. That is why, Russia due to its size, leadership in integration process and enormous political and economic power can influence the adoption of solutions supporting its domestic producers and defending them from foreign competitors. In practice, it means that there are still hundreds of exceptions in many product lines. Thus, according to the agreement about creation of the CU signed on October 6, 2007¹²⁰ *the Customs Union of Russia, Belarus and Kazakhstan foresees creation of integrated customs territory where customs duties and economic restrictions are not used, except for special security, antidumping and compensatory measures. The*

¹¹⁹ CBN News. [on-line]. [cit. 2014-2-23]. Available from WWW:

<http://www.cbn.com/cbnnews/world/2014/April/1-Dead-in-Eastern-Ukraine-Shootout-/>

¹²⁰ The Eurasian Economic Commission. [on-line]. [cit. 2014-2-24]. Available from WWW:

<http://www.tsouz.ru/AboutKTS/Pages/37.aspx>

matter is that extent of “special security, antidumping and compensatory measures” is not clearly expressed. Russia as initiator and main executive of the whole integration has 57 % of total voting power in the Commission of the CU; therefore its state structures are able to protect its producers better than those of Belarus and Kazakhstan that must annually negotiate quotas on exports of important for them goods on Russian market. In fact, it means that there is still no natural competition inside the Customs Union while the volume of imports from outside the integration is already limited by state regulations. Full elimination of all internal quotas and restrictions expected from 2015 when the agreement about establishment of the Eurasian Union will get into force. For a group of smaller players – Belarus and Kazakhstan – it is a turning point when these countries will get so long time expected real preferences: the opportunity to buy Russian energy resources at its internal prices and unlimited access to Russian oil pipeline. Thus, for Belarus and Kazakhstan year 2015 is such a break-even-point when the initial disadvantage of their goods on Russian market will be replaced by the free movement of all kinds of goods and capital, which will expose them to the way most tangible benefit that promised Russia while creating the customs union – the access to its energy resources at internal prices.

However, in exchange for these preferences (which are estimated to reach 30 bn USD annually¹²¹) Russia is expecting closer political integration from its CU partners and creation of supranational authorities similar to the EU whose competences will cross over issue of solely common economic policy. Thanks to its geographical size and politic power Russia will have indisputable domination there. These changes already affected the decision-making process inside the CU since Leaders of both Belarus and Kazakhstan have repeatedly disputed any further politicization of the Customs Union and thus possibility of creation of any supranational legislative body.

7.2. Self-isolation and growth of political dependence from Russia

Belarus is stuck in the middle of the process of integration with Russia. If Belarus had previously been the subject of this process, it is now transforming into an object that tries to protect its own sovereignty through minimizing its activities in integrative process.

¹²¹ According to the Deputy Minister of Finance of Russia Sergei Shatalov. Available from WWW: <http://news.tut.by/economics/391078.html>

In the past, Lukashenka's regime showed more interest in the development of these projects, having seen long-term perspectives for bolstering itself. Now Belarusian authorities are trying to stop as many of these integration projects from proceeding forward as they can. Belarus' lack of involvement into any other integration projects only deepens its dependence on Russia.

Belarus remains Russia's main ally in Eurasian integration process, although its role of a partner is more of a lord-vassal relationship. Belarus has always supported Russia's political initiative and took part in several integrative projects on post-soviet space:

- The Commonwealth of Independent States created in December 1991 where Belarus was one of the three founders. This structure initially declared development of close economic integration, but in the end it became not more than just a discussion platform on post-Soviet space.
- In 1993, Belarus joined the Russia-controlled Organization of Collective Security Treaty – a military alliance that currently unites Russia, Kazakhstan, Armenia, Tajikistan, Kyrgyzstan and Belarus.
- The Union State of Belarus and Russia that since 1997 has had its own budget and built its own system of governing bodies. Nowadays, this project is more politically dead than alive; however it brings benefits to many ordinary people (e.g. common citizenship that gives same rights for working and studying, unified pension system etc.).
- The Eurasian Economic Community established in 2001 by Belarus, Russia, Kazakhstan, Kyrgyzstan and Tajikistan became a preparatory structure to a common market of these countries. The EEC gives Belarus stabilization loans and requires the privatization of enterprises in return. Formally, the international organization gives loans for reforms, but de facto Russia gives credits and requires Belarusian companies to be sold off to Russia.

The conversion from a partner to a vassal, however, became most noticeable during the creation of the Customs Union between Belarus, Russia and Kazakhstan and the Common Economic Space consisting of same countries. Membership of Belarus in the Customs Union with Russian and Kazakhstan opens several effective channels for Russian influence in the country, and what is even more important, it significantly changes the character of this influence. Even before the Customs Union, the Belarusian economy had been extremely dependent on the Russian Federation, but membership in the CU gave

Russia specific instruments with which to use this dependency. The Customs Union directly or indirectly affects the following vital issues for Belarus: the price of Russian oil for the Belarusian market, oil export duties, conditions for Belarusian export and import from Russia and the value of Belarusian custom duties for imported goods. Significant changes in Belarusian policies concerning these issues after joining the CU have had very controversial effects on the Belarusian economy. In these terms, the CU rules provoke three major contradictions between Belarus and Russia that due to stronger political power of the latter tend to put Belarus in disadvantageous position.¹²²

First, the volume of crude oil imported from Russia and the level of oil export duty paid to the Russian budget. Belarus insists on the large volume of imported oil and minimal oil export duty. The Russian Federation intends to supply Belarus with rather large volumes of oil, but dramatically decreases the revenues of the Belarusian export of oil-refined products by imposing high oil-export customs duties.

Second, different conditions for Belarusian export and import from Russia. Over a very long period of time, the Belarusian authorities have been lobbying intensively for the most favorable conditions for Belarusian export to Russia and have been almost ignoring the effects of Russian imports on the country's domestic market. Today, Belarus continues to be the number two trade enemy for Russian exports in the World (after the EU), although it is gradually withdrawing these limitations under pressure from the CU.

Third, Customs control over the border with the EU. Despite the necessity of implementing the same customs policy, the Belarusian authorities try to continue to follow (unofficially) their own rules at custom offices along the borders with the EU and Ukraine. Generally, the Russian and CU custom requirements are more open than the Belarusian customs policy on the ground. This contradiction may grow as Russia continues the liberalization of its international trade as a consequence of its WTO membership.

While integration processes with its eastern partners continues to evolve, Belarus crucially lacks institutional linkages with other structures. According to the European Integration Index 2013, Belarus has the weakest relationships with the EU among all the Eastern Partnership countries. More contacts with EU partners, however, could help Belarus emancipate itself from excessive influence from Russia. But the real situation is that Belarus' regime is reluctant to choose a European path of development which from a

¹²² The Eastern Europe Studies Centre. [on-line]. [cit. 2014-2-21]. Available from WWW: [http://www.eesc.lt/uploads/news/id505/Bell_2013_5\(35\)n.pdf](http://www.eesc.lt/uploads/news/id505/Bell_2013_5(35)n.pdf)

big part is simply dictated by its financial dependence on the Kremlin. The European Union for its part just cannot propose same kind of financial support. While the EU has appropriated about 700 mio USD in technical aid to Belarus since 1991 – Russia gave its neighbor 14 times more in 2012 alone. Thus the choice of Belarus’ political preferences is clear – further intensify integration with Russia in exchange of generous economic preferences even though they can mean increasing political influence from its bigger neighbor.¹²³

7.3. Road towards the Association Agreement with the EU blocked vs. indirect approximation with EU standards

Being a member of the EurAsEC Customs Union, not to mention the Eurasian Union, means the country cannot proceed towards conclusion of the Association Agreement (AA) and the Deep and Comprehensive Free Trade Area (DCFTA) with the EU. Ukraine, which became a battleground between the two big players’ integration projects, is a good example. Not that official Minsk really expected to move towards the Association agreement with the EU, as it does not even have a valid Partnership and Association Agreement. Still, the choice of Eurasian integration apparently makes advancement of relations with the EU towards the AA impossible.

With this in mind, paradoxical as it may seem, Belarus adopts European standards in a number of fields through its participation in the Eurasian projects. First, to some extent, the CES legal base is developed in compatibility with the EU’s. The free trade agreement between the CIS countries is largely based on WTO principles and partly on EU technical standards (i.e. competition policy), too. According to the 2012 SME Policy Index, assessed by the OECD, the European Commission, European Training Foundation and the European Bank for Reconstruction and Development, Belarus leads the Eastern Partnership countries in the area of standards and technical regulations. Experts maintain that this advancement was possible because Belarus has aligned its infrastructure in the

¹²³ Analytic portal “Belarus Digest” [on-line]. [cit. 2014-2-23]. Available from WWW: <http://belarusdigest.com/story/belarus-and-customs-union-subject-object-integration-16867>

area of sanitary and phytosanitary rules through the EurAsEC Customs Union.¹²⁴ Second, the Treaty on the Functioning of the Customs Union in the Multilateral System of November 2011 ensured that the WTO rules-based regime would prevail over the provisions of the Customs Union. Therefore, the Customs Union legislation is made consistent with modern international norms.¹²⁵

7.4. Potential impacts of Kazakhstan's entry to the WTO

The Customs Union removed almost all barriers for mutual trade between the member states, while for the protection of intra-CU manufacturers introduced a single customs tariff of 10,6 % was introduced. These measures contributed to substantial growth of mutual trade and increased competition between producers of the three countries. In connection with the entry of Russia into the WTO – the Eurasian Economic Commission adopted new common customs tariff rates for approximately 10 % of headings, or about 1000 positions. As a result, e.g. taxes on new cars were reduced by 5 % – from 30% to 25%. Reduction of import duties also affected food products (meat, dairy products, vegetables and fruits) as well as textile products, light industrial products – the product group that are so important for Belarusian exports in Russia. It will be followed by a gradual reduction of a SCT of the CU to the level of 7,5-7,8 % till 2018. Russia's WTO entry intensified competition with manufacturers and service providers from extra-CU countries that managed to affect the competitiveness of domestic CU producers, in particular Belarusian (for more, see 5.5. Effects of Russia's entry to the WTO on Belarus).

Now negotiations with the WTO are held by Kazakhstan that is planning to be admitted by the end of 2014. But if Russian diplomats managed to negotiate a transition period of several years with a gradual reduction of tariffs for most sensible product lines, then the lobbying power of Kazakhstan seems to be much less. In case if Kazakhstan joins the WTO on a common basis it implies much lower tariff rates than were bargained by Russia in 2012. Thereby, the Kazakhstan market will be flooded by freely coming foreign manufacturers whose products can automatically enter Russian and Belarusian markets at

¹²⁴ OECD/ (2012), SME Policy Index: Eastern Partner Countries 2012: Progress in the Implementation of the Small Business Act for Europe, OECD Publishing.

¹²⁵ Eastern Europe Studies Centre. [on-line]. [cit. 2014-3-23]. Available from WWW: [http://www.eesc.lt/uploads/news/id505/Bell_2013_5\(35\)n.pdf](http://www.eesc.lt/uploads/news/id505/Bell_2013_5(35)n.pdf)

lower prices than the same goods coming from third countries via Russia. That directly threatens the economy of Belarus, especially such important export positions as trucks, buses, agricultural vehicles and food products. In spite of significant concessions that were given by the WTO for Russia for these product lines there was a significant reduction in the presence of Belarusian manufacturers on CU market after 2012. And if Kazakhstan admits lower import duties from the WTO it automatically means further worsening of the position of Belarus' producers on the CU market and on-going stagnation of its economy.

So head of international trade laboratory of the Gaidar Institute for Economic Policy Alexander Knobel believes that negotiations on Kazakhstan's accession to the WTO may be unpredictable. *"If Kazakhstan decides to join the WTO on terms that push the EU and the USA, it can lead to anything. Either to Kazakhstan's exit from the CU, or to the fact that the union will continue to exist but with rolled back integration achievements; or to the fact that Russia, wanting to preserve the union at any cost, will go to any conditions put forward by Kazakhstan. It should be understood that Belarus is likely to be against it. Therefore in order to keep the project, Russia will have to compensate for the loss of Belarus, and then Armenia, which appears to join the CU soon,"* – said the expert.¹²⁶

It is clear that the worst situation for Belarus can appear when Kazakhstan agrees on lower import duties with the WTO. Thus, even though Russia hypothetically agrees on substantial compensation in order to retain Belarus within the union it will likely require reciprocal steps from Belarus, like privatization of its key industries in favor of Russian capital. This will logically lead to even deeper economic and political dependence of Belarus from its big neighbor. However, the situation can be resolved smoothly in case Kazakhstan achieves the same conditions on customs tariffs, as Russia. Actually it corresponds to official position of Astana which is consulting its negotiation steps to the WTO with Russia. But even if the result of Kazakhstan's negotiations is positive it still leaves the same import duties for the CU as were negotiated by Russia in 2012. Therefore, Belarusian producers will still face a significant disadvantage compared to its colleges from Kazakhstan and Russia that will get access to the markets of the third countries but Belarusian – no.

¹²⁶ News portal "TENGRINEWS". [on-line]. [cit. 2014-3-15]. Available from WWW: <http://tengrinews.kz/markets/planyi-kazahstana-vstupit-v-vto-napugali-rossiyskih-ekspertov-248724/>

7.5. Forecast of Belarusian economic development in the nearest future

The year 2013 was characterized by Belarus's deepening economic dependency on Russia. It became apparent that the generous socio-economic model of Belarusian state including heavily subsidized utilities and mortgage loans; free health care and education; a retention of the Soviet-era energy- and material-intensive industries and state-owned agriculture; as well as the post-Soviet region's most extensive, in per capita terms, residential construction-cannot be sustained without external aid. The excess of imports over exports and slowing economic growth exacerbated the situation. Russia came to the rescue, transmitting the fifth (450 mio USD) tranche of the Eurasian Economic Community's 3 bn USD crisis loan to Belarus (in April 2013) and pledging to transmit the sixth tranche in 2014.

According to the Business Monitor International report¹²⁷, Belarus's economic outlook for the next years has improved somewhat from the direct projections following the potash dispute in mid-2013, as potash trade and political relations with Russia recover. However, it is not expected to see a significant rise in net exports, due to the relative strength of Belarusian ruble against regional peers and Ukrainian trade being disrupted by the flare up between Kiev and Moscow.

We see risks to Belarus's inflation outlook in 2014 and 2015, as the government places pressure on the central bank to implement measures to stimulate growth, rather than targeting inflation. This will likely come in the form of continued ruble weakening as well as an expansion of the money supply and further reductions to reserve requirements at the central bank.

Belarus's current account deficit will remain substantial over the coming years, driven by declining export volumes and a reduction in remittances from Russia. The outlook is made bleaker by the fact that the deficit continues to be financed by depleting FX reserves and the extension of credit lines from Russian government that are subject to the political whims of Moscow.

¹²⁷ Web collection of market intelligence products and services "MarketResearch.com". [on-line]. [cit. 2014-3-24]. Available from WWW: <http://www.marketresearch.com/Business-Monitor-International-v304/Belarus-Business-Forecast-Q2-8094681/>

Belarus will remain fairly insulated politically from the ongoing crisis in Ukraine, with its allegiances firmly skewed towards Moscow and little chance of political reorientation towards Europe. In the longer term it is not possible to rule out similar upheaval, especially around the November 2015 Presidential election, but the core scenario remains one of stability under the firm control of President Alexander Lukashenko.

It is supposed that Russian ruble and the Ukrainian hryvnia continue to weaken in 2014 and 2015, and the Kazakh tenge should remain around current levels given the country's substantial FX reserves. In order to regain Belarus' export competitiveness further weakening of Belarusian ruble is expected in 2014 and 2015.

Given that the situation on the ground in Ukraine is fluid at the time of writing, there remain risks for Belarus to remain politically stable. It is not in a core scenario for a ground war to break out in Crimea or Ukraine's eastern regions, but if this were to occur, it would undoubtedly raise Belarus's security risks as a wider conflict in Ukraine could draw in neighboring states.

The key risk to Belarus' macro outlook is a sharp devaluation of the ruble by the central bank, rather than a managed depreciation. If key trading currencies sell off more than expected, or Russian government is unable or unwilling to provide additional financing beyond the 2 bn USD loan agreed in 2013, devaluation would become a much more realistic possibility. Of course the worst case scenario for the ruble would be an escalation of violence in Ukraine and the outbreak of a ground war in the country. This would have significant negative spillover effects for the currency, as Belarus's macro outlook deteriorates further on a decline in regional trade as well as fixed investment.¹²⁸

¹²⁸ Jamestown Foundation. *Belarus: Hallmarks of 2013 and Prospects for 2014*. 9 January 2014, Eurasia Daily Monitor Volume: 11 Issue: 4. [on-line]. [cit. 2014-4-23]. Available from WWW: <http://www.refworld.org/docid/52cfeb114.html>

Conclusion

The analysis of economic effects of Belarus' participation in the EurAsEC Customs Union in 2009-2013 has shown no major sign of trade diversion. Almost all indicators of Belarus' foreign trade (both inside and outside the CU) were growing depending on the general situation in the partners' economies and level of inner demand. The observed period can be roughly divided into three parts that share similar economic tendencies and generally explain the development of Belarus' major economic and foreign trade indicators:

- 2008-2009: the period of global economic crisis and drop in almost all macroeconomic indicators;
- 2010-2011: the period of revitalization of the economy concurred with extensive anti-crisis financial inflows, multiple devaluations of national currency and full-value launch of the CU in 2010 through implementation of the SCT and the CCC;
- 2012-2013: the period of slowing down of Belarus' economy and decline of its foreign trade due to decreased demand for Belarus' export goods on the CU market which was mainly caused by Russia's economic recession and its accession to the WTO in August 2012.

As cleared up in the research, implementation of the SCT and the CCC has not significantly changed the proportion of Belarus' trade in goods with CU and non-CU countries. The shares of both groups have generally stayed stable and fluctuated according to the development of demand on targeted markets. On the whole, the development of Belarus' foreign trade has had positive trend till 2012 when Russia officially joined the WTO and opened the doors of the CU for foreign goods on the same conditions as for CU members. This step had a crucial effect on Belarusian intra-CU exports that stagnated in 2013 and already shows clear features of reduction in 2014.

As in case of foreign trade in goods, Belarus' membership in the CU had no significant distortion effect on its foreign trade in services and just corresponded with general positive tendency that settled down before. For the period from 2008 till 2013 Belarus' annual imports of services grew by 62 % and exports – by 59 % while no significant disproportions of intra-CU and extra-CU shares were registered. Normally the growth was caused by positive economic development on important for Belarus foreign markets – the EU and Russia – and by growth of investment inflows to Belarus' tertiary

sector. The only major change took shape after 2012 when a single market of the CU was introduced. That led to smooth growth of intra-CU share of Belarus' exports that finally amounted to 34 % in 2013 (compared to 29 % in 2011).

If we look at the development of investment inflows to Belarus before and after its accession to the CU, we can see the tendency of its continuous increase. Thus, only after 2 years after official launch of the CU in January 2010 the situation has improved substantially. Compared to 2009, the amount of total investment inflows in 2011 doubled while the amount of FDI almost tripled. There was also a qualitative change in the structure of foreign investments to Belarus when the share of FDI in total value of investments increased from 52 % in 2009 to 74 % in 2013. That clearly proves that Belarus' membership in the CU had positive effects on its investment climate and helped it attract more foreign capital.

Belarus' accession to the CU also had quite positive effect on its state budget. According to official statistics, with the tendency of annually growing Belarusian budget the share of profits from the customs clearance was increasing too. Thus, when their share in 2009 was only 27 % of all budget inflows than the next year after the implementation of the SCT this figure grew at 42 %. Generally, since 2000 the growth of Belarus' incomes from customs clearance was positive and has not changed till now.

After double-digit growth in CU mutual trade in 2009-2011 the situation changed in the second half of 2012 when internal trade grew by only 3 %. As analysts from the Brussels-based Center for European Policy Studies concluded, the short-term effects of the introduction of the Customs Union are over and the CU economies start to experience features of economic recession. Russia, the motor of the integration that has about 90 % of the union's economic power, is slowing down its growth rate: 3,4 % in 2012; 1,3 % in 2013 while the forecast for 2014 ranges from -1,8 to 1,4 % depending on the solution of Ukrainian politic crisis. While Kazakhstan's mineral-based economy has been recently growing at 4-6 % annual rate, the economy of Belarus based on manufacturing and processing industries and thus more connected to partners' state of economies (especially Russian) had significant problems. Thus, as opposed to its partners from the CU, Belarus' economy decreased by 1,4 % in 2012 and grew by only 0,9 % in 2013. The downswing of national GDP in 2012 was fostered by a crucial for Belarus fact – Russia has entered the WTO in August 2012. Since Belarus accepted Russia's commitments on market access for goods coming from the WTO countries, a certain “compulsory trade liberalization” has

occurred which caused a drop in Belarus' exports as its competitiveness on CU market significantly declined. This situation caused overstocking of finished goods in warehouses, reduction of production volumes and wages. Lots of qualified labor hence left Belarus (mostly to Russia) which means significant brain drain for the country. Anyway, the recession of Belarusian economy is continuing (the GDP of Belarus decreased by 1,6 % in January-February 2014 comparing to the same period of previous year) which is accompanied by exports decline and further deepening of Belarus' negative trade balance and growing national debt.

As was already mentioned, in the first years of its existence the Customs Union exhibited rather impressive growth of its internal trade, even though it was primarily due to the recovery from the crisis of 2009, when Belarusian GDP fell by 19,1 %. However, this trend was not only the sign of CU countries. Thus, Ukrainian and Belarusian trade with Russia demonstrates that membership in the Customs Union has not critically affected trends in bilateral trade. In 2011, Belarusian trade with Russia increased by 40,7 %, while Ukraine's increased by 36,1; in 2012, both fell, by 9,4 and 10,8 % respectively. Thus, we can see that even though Belarus' economy was continuously growing since its entry into the CU it did not give any tangible comparative advantages in relation to its neighbors that did not join the CU integration. The development of trade of both Belarus and Ukraine with its main economic partner – Russia – had similar path that was provided by already signed agreement of free trade in goods with Russia in early 1990s. Hence, the only tangible benefit that got Belarus was low price for Russian gas and oil, which were about 2,5 times cheaper for Belarus in 2012 than for Ukraine. This advantage is double-sided though: together with favorable conditions for the development of the economy (cheap energy means lower prime costs of production) it made Belarusian authorities reluctant to make any structural reforms and modernize the economy, even though the IMF was advising these steps since early 2000s. On the contrary, it led to further concentration on mineral-processing industry based on subsidized Russian oil. This sector has continuously occupied the first place in Belarus' exports with around 35 % of total value while Belarus appeared on the third position in the rating of most oil-dependent countries in 2013. In reality it means further dependence on Russia because oil needed for their production is bought exclusively from Belarus' eastern neighbor. Moreover, due to regulations of the CU the amount of subsidized oil (at inner Russian price) that Belarus can buy from Russia is now limited to its local consumption and considerably depends on the political will of

Moscow. The same painful topic is connected with annual negotiation of prices for Russian natural gas that is still used for production of about 80 % of Belarusian energy. Unfortunately it clearly shows Russia's intentions to maintain Belarus into its zone of political control and use economic pressure as instruments of achieving its goals.

The problem of Belarus' growing economic dependence from Russia is also closely connected with continuously narrowing breadth of Belarus' foreign trade that makes its export-oriented economy potentially more exposed to trade volatility and exogenous demand shocks. Since getting its independence, Belarus has been constantly inclined towards concentration on post-Soviet markets (especially Russian that provides half of Belarus' turnover now) at the expense of other countries, especially the EU. This in its turn does not allow technological exchange that could occur through closer economic cooperation between Belarus and western countries.

Together with some economic problems that were already mentioned above, the CU brought bigger political dependence of Belarus and Kazakhstan from Russia. Having 57 % of total voting power in the CU Commission enables Russian state structures protect its producers better than those of Belarus and Kazakhstan that must annually negotiate quotas on their exports on Russian market. Additionally, the co-operation rules dictated by Moscow (especially the single customs tariff), which strengthened the protectionist policy applied towards third countries, proved to be unfavorable for Kazakhstan and Belarus and caused an increase in the prices of third-party goods, and thus contributed to improving the price competitiveness of goods from Russia, despite their potentially poorer quality. The efficient operation of the Customs Union was furthermore impaired by the inconsistent and ambiguous Common Customs Code, which leaves room for free interpretation of its provisions to each of the customs services. In this way the quotation of B. Franklin introduced in the very beginning of the thesis (*"No nation was ever ruined by trade."*) appears to have its negative sarcastic sense in case of Belarus.

In general, Belarus's participation in the EurAsEC Customs Union is a good example of the divergence between immediate interests of ruling elite and long-term national interests. As was already noted, together with intensive growth of internal trade Eurasian integration brings a number of conflicting outcomes for Belarus. On the contrary, some negative short-term consequences for the economy may turn out to have a positive effect in the long run. For instance, the shock from the "compulsory trade liberalization"

that Belarusian industry experienced after Russia's accession to the WTO creates an incentive for enterprises to modernize and enhance their competitiveness.

Conversely, the allegedly positive effect on the economy in the short and medium term may have adverse and even deleterious effects in the long run. The deepening energy and economic dependence from Russia and narrowing of Belarus' foreign trade breadth towards CIS countries can later lead Belarus to total loss of control over its economy and thus inability to protect its national interests. The situation unfortunately does not seem to change a lot in the nearest future. Mix of political, geopolitical and economic interests determines all of Russia's long-term strategy towards Belarus and makes it an outpost of the whole Eurasian project. In spite of high costs of Belarus' politic loyalty (huge energy subsidies and concessions for its producers) Russian elite is currently satisfied with never-changing and stable Belarusian government. In future years, in order to support the functioning of Belarusian socioeconomic model and to avoid the risk of radical political changes in the country, Russia will continue to provide Belarus with a rather large volume of crude oil, comparably low gas prices and unrestricted access to its market for Belarusian exports. For Belarusian people though it means continue living in a non-democratic country that is falling deeper into tight embraces of its big eastern neighbor.

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