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Belarus and the Eurasian Union: incremental integration

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›› An assessment of Belarus's membership in the Common Economic Space (CES) offers an insight into what a future Eurasian Union (EAU), to be launched in 2015, may look like. The CES, formally established in January 2012, is seen as a pet project of Russian President Vladimir Putin, largely based on the Customs Union established in 2009 between Russia, Belarus and Kazakhstan and on the Eurasian Economic Community (EurAsEc). The new integration process reflects Moscow's efforts to create a supranational regulatory framework inspired on – and partly 'copy-pasted' from – the European Union (EU). However, Russia has given potential members little time to integrate, decision-making remains opaque, and a full-fledged Eurasian Union is likely to be delayed by Belarus and Kazakhstan.

Minsk is carefully assessing Moscow's proposed framework, while trying to strike a balance between its policies towards the EU and Russia. While the EU places transparent political and economic conditionalities on prospective member states (the Copenhagen criteria), Moscow is paying Minsk for membership, while expecting the new supranational regulatory framework to foster a process of economic integration similar to Western Europe's.

Belarus is trying to avoid making hard concessions to Russia and, at the same time, it seeks not to break bridges with the EU. In this sense, Minsk takes advantage of existing loopholes within CES and creates new ones to circumvent rules and maximise short-term economic

HIGHLIGHTS

- Belarus's main motivation to engage in the Common Economic Space is external rent-seeking, in particular energy subsidies from Russia which are essential to the Lukashenka regime.
- Belarus will reluctantly consent to further Eurasian integration whilst using various loopholes to maximise its benefits.
- While Central Europe and the Baltic states were willing to pay the price of hard reforms to achieve their European dream, Belarus wishes to get paid for Eurasian integration.

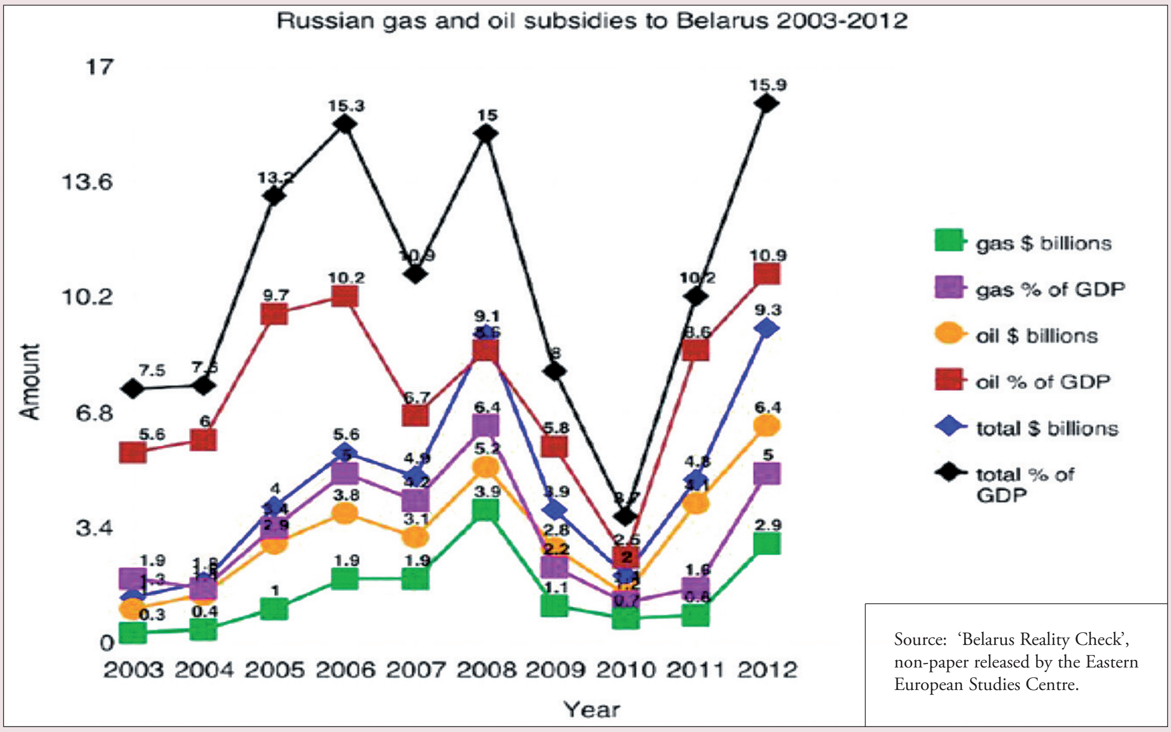
benefits by extracting rents (subsidies) – or at least trying to – from Russia. The competences and decision-making procedures of the Eurasian Commission – the CES supranational governing body – leave substantial room for political manoeuvre. This approach already worked with the Union State of Russia and Belarus, a never-ending integration project that started in 1996. But Minsk has no interest to press for a full-fledged Eurasian Economic Union any time soon, unless it is on its own terms. Yet, Belarus may be underestimating the seriousness of Russia's new integration project and its willingness to proceed swiftly.

BENEFITS FOR BELARUS

Economic gains. Russia's financial subsidies – which are vital to Belarus's state-controlled economy – come in the form of cheap gas prices, re-exports of refined oil products from Russian crude oil and the preferential treatment of Belarusian goods on the Russian market.

According to available estimates, gas and oil subsidies amounted to 15.9 per cent of Belarus's GDP in 2012. Russia has been attempting to reduce its indirect subsidies by lowering oil export volumes in 2013. A previous decrease in subsidies in 2010 was interpreted as a response to Minsk's reluctance to join the Kremlin's integration plans. This evidences Russia's (unwritten) political conditions on CES parties and indicates the kind of pressure that it will exert on potential EAU member states. The Kremlin's message is clear: only further integration will bring further subsidies.

Belarus also hopes to gain access to Kazakhstan's oil through the Eurasian project. Belarus and Kazakhstan covet Russia's key role as a transit country, including for Kazakhstan's energy exports to Belarus and further to the EU. Kazakh President Nazarbayev stated during an official visit to Minsk in May 2012 that the parties hoped for further decentralisation of Russia's energy transport market. Moscow may need to trade off progress in the integration process with some



Source: 'Belarus Reality Check', non-paper released by the Eastern European Studies Centre.

concessions concerning transit issues, making it easier and cheaper for Belarus to tap into Kazakh energy resources. However, these plans have not materialised as of yet.

Regarding trade, given the common external tariffs set up by the Customs Union Belarus can no longer manipulate tariffs to protect its own market. However, it can try to block Russia's free trade agreements (FTAs) with third countries to ensure its privileged position on the Russian market, as evidenced in a recent case involving New Zealand. Belarus is the main exporter of milk products to Russia and is allegedly reluctant to give the green light to a Customs Union-New Zealand FTA that would likely harm Belarusian milk producers and have detrimental effects on the country's dairy industry.

Migration. Belarus also benefits from labour mobility towards Russia. Despite temporary labour migration – about 200,000-300,000 people annually – posing challenges to the Belarusian labour market, which suffers from shortages in areas such as construction, transport and healthcare, this is outweighed by lower pressures on Belarus's saturated labour market in other sectors and in terms of unemployment benefits, as well as by the inflow of remittances that boost the country's balance of payments. That said, a bill to amend Russia's Law on Citizenship, which foresees simplified procedures to acquire Russian citizenship for 'Russian compatriots', is pending in the Russian Duma. If it is approved, Moscow will be able to use the law as a tool to influence Belarus through the mass distribution of Russian passports to Belarusian immigrants, thus making them (and their families) permanent residents.

Political leverage. Russian President Putin attaches great importance to the Eurasian integration project. This could give Belarus some leverage in its relations with Russia. As Moscow's long-standing strategic ally, Minsk plays at times the role of a cherished troublemaker. Officials in Minsk believe that they can rely on Russia's economic and political assistance, as the regime's collapse would likely imply the failure of the Eurasian Union. Minsk's leverage also depends on the fact that other envisioned partners, foremost Ukraine, are either more hesitant or altogether unwilling to join the Eurasian Union.

Moreover, Belarus is better placed to influence decision-making in the CES than in the Customs Union. In the latter's Commission, the Russian Federation held 57 per cent of votes while Belarus and Kazakhstan only had 21.5 per cent each. The CES decision-making mechanism satisfies Minsk's expectations of 'equal' political weight in integration structures. *De jure* equal footing of all member states and consensus-based decision-making enable Minsk to slow down the integration process. The Eurasian Economic Commission is centred mainly on executive tasks, but even its monitoring mechanisms are relatively weak. The vague distribution of functions among the Commission's Council and Board makes decision-making procedures rather cumbersome, which can play to Minsk's advantage.

WHAT BELARUS HAS TO LOSE

Worsening trade position and FDI diversion. To date, there is no strong evidence of sustainable trade-creation effects from the Customs Union. According to a recent study carried out by the Centre for European Policy Studies (CEPS), short-term trade-creation effects appear rather precarious. Both Belarus and Kazakhstan trade with Russia intensively, but their mutual trade and investment cooperation remains meagre. Belarusian trade with Kazakhstan accounts for merely 1 per cent of Belarus's overall trade. As of early 2012, not a single Kazakh company was registered in any of Belarus's six free economic zones.

Trade relations between Russia and Belarus are often tense. Since the launch of the CES a number of small, low-visibility trade wars have taken place, especially regarding machinery and dairy products. Different CES member state companies that struggle to defend their economic interests resort to national regulatory agencies for

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assistance. In this kind of confrontation, the largest and more influential partner (Russia) tends to be in a stronger position.

Russia's World Trade Organisation (WTO) commitments have effectively become an integral part of CES legislation. Given that Belarus, which is not a WTO member, has to accept Russia's obligations on market access for goods, this 'compulsory trade liberalisation' has an adverse effect on Belarusian exports to Russia (such as pharmaceutical products, refrigerators, tractors and motor vehicles for the transport of goods). On the Belarusian domestic market, the largest impact is on trucks, tractors, pharmaceutical products, fisheries and light electronics.

Eurasian integration, coupled with Russia's WTO membership, also endangers Belarus's ability to attract FDI from anywhere else but Russia. In the past five years, Russian FDI to Belarus has increased by over 1,000 per cent and this trend is likely to continue. WTO membership creates additional advantages for Russia when it comes to competition over FDI, on top of a better business climate and relatively more predictable property rights and stable economic institutions. The trumpeted prospect of attracting Chinese investment to Belarus is also doomed. A small market with unstable property rights such as Belarus can become neither an investment platform nor a trustworthy offshore zone.

Critical energy dependency on Russia. Cheap Russian gas, high volumes of crude oil destined to be refined and re-exported to the EU, coupled with the 2009 decision to rely economically and technologically on Moscow over the building of a nuclear station, have made Belarus fully energy-dependent on Russia. This is a matter of macroeconomic sustainability – survival – for Belarus. While Russian gas is a feedstock for the Belarusian industry and is used to heat Belarusian homes, oil products are its major export goods to the EU (30-35 per cent of total exports) and represent a significant portion of its GDP. In 2011, Minsk sold the remaining shares of its gas transmission operator to Gazprom for $2.5 billion, securing a significant gas price discount. This sale suggests how Minsk may proceed with further privatisation. Belarus has asked for above market prices, which only Russia would pay (including the gas discount). In addition, Minsk, not the new owners, continues to set domestic gas prices (what is key for the regime) and sets (and collects) transit fees. Gazprom does not own the land, only the actual pipeline. This can be seen as a win-win deal: Minsk gets the much-needed cash, while Moscow gets a much-needed PR victory and undercuts prospects for the diversification of Belarusian energy supplies.

Belarus's vulnerability is further aggravated by Russia's reduced dependence on Belarus's oil transit capacity (via the 'Druzhba' pipeline) to the EU after the launch in 2012 of the BPT-2 oil terminal in St Petersburg.

Minsk does not have strong incentives to diversify its energy supplies as long as Russia provides energy subsidies. Besides, the envisaged Belarus-Venezuela energy cooperation did not last long and attempts to attract Kazakhstani and Azerbaijani oil to Belarusian refineries so far have not brought the expected results: they have mainly served to put additional pressure on Russia for subsidies. Due to Moscow's intention to reduce crude oil supplies to Belarusian refineries and given potentially falling revenues from refined oil products (as a result of lower crude oil prices), however, Minsk may consider the privatisation of its refineries if it means achieving a high oil price and control over privatised companies.

BELARUS'S 'LOOPHOLES POLICY'

For the past two decades, Minsk has been successfully creating and sustaining rent-flows from Moscow (discounted gas, oil, privileged access to Russia's market). In addition, Belarus has also been taking advantage of the various loopholes in the Customs Union and CES to soften its commitments and obligations therein.

While the regulations of both the Customs Union and CES leave some room for manoeuvre, they require member states to have a transparent and predictable customs preferences system regulated at the supra-national level. Decision #130 of the Customs Union's Commission of 27 November 2009 on customs and tariff regulations exempts from import duties goods which are intended for 'an investment project within priority economic sectors'. In practice, however, through a presidential decree of August 2009, Belarus is able to distribute preferences and discounts to all investors that have entered into investment agreements with the state.

As long as Moscow provides subsidies, Minsk will reluctantly pursue incremental integration

Decision #130 also foresees that companies can obtain customs exemptions if imported goods are related to the holding of the 2014 World Hockey Championship. But Belarus seems to have interpreted this provision in a very extensive way by providing exemptions relating to construction sites, apartment buildings, trade facilities and office buildings which have little connection to the championship.

Furthermore, Minsk adopts normative measures 'for special use', which are not disclosed to the public or third parties, to regulate major investment projects. The Eurasian Economic Commission has competences in the areas of competition and regulation of state monopolies, by means of which it can request the authorities of member states any relevant information, except for 'classified' information and data with 'restricted dissemination' according to member states legislation. Despite its formal regulatory competence, the Commission may therefore be refused information on measures adopted 'for special use', preventing it from effectively carrying out its functions and diminishing its authority in Belarus

CONCLUSION

Belarus only agreed to join the CES after Russia made it clear that it would not provide any further substantial financial backing otherwise. As long as Moscow provides subsidies, Minsk will reluctantly pursue incremental integration. This process echoes Belarusians' opinion in the polls. According to a recent survey published by the Belarusian Institute for Strategic Studies, over 70 per cent of Belarusians could accept closer integration with Russia on the condition that this contributes to improving the economic situation of the country. Belarus focuses on short-term financial benefits and political brinkmanship by exploiting legal loopholes in the integration structures but it will increasingly struggle to maintain control over important sectors of its economy, especially if Russia is able to restrain Minsk's rent-extracting policies. While Central Europeans or the Baltic countries were willing to pay the price of hard reforms to fulfil EU standards, Belarus wishes to get paid for Eurasian integration.

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